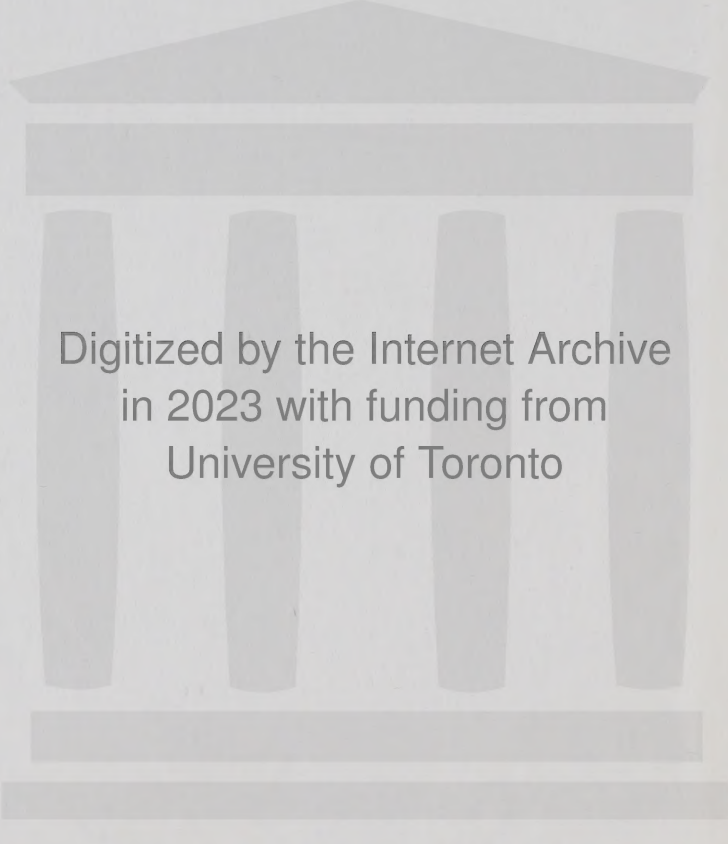

Report of the Study Committee on Bankruptcy and Insolvency Legislation

Canada 1970

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Bankruptcy and Insolvency

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CANADA 1970

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Ottawa, 1970

The Honourable Ron Basford, P.C., M.P.
Minister of Consumer and Corporate Affairs
Ottawa, Ontario

SIR,

We, the undersigned, members of the Committee appointed "to review and report on the bankruptcy and insolvency legislation of Canada", have the honour to submit our Report.

Roger Tassé,
Chairman

John D. Honsberger, Q.C.

Pierre Carignan, Q.C.

Raymond A. Landry,
Secretary

June, 1970

TABLE OF CONTENTS

PART III
PROPOSALS FOR A NEW ACT

INTRODUCTION

0.0.01 We were appointed in February 1966 by the then Minister of Justice, the Honourable Lucien Cardin, who at that time was responsible before Parliament for the administration of the *Bankruptcy Act,* "to review and report on the bankruptcy and insolvency legislation of Canada."

0.0.02 The committee was meant to be neither a committee of inquiry nor investigation. It was our responsibility to review the existing legislation and to make recommendations, in a draft form, for necessary amendments. Accordingly, no public meetings were held and no formal evidence was taken. However, we did have the advantage of the advice and useful expressions of opinion of many interested persons and organizations.

0.0.03 In June of 1960, the Honourable Davie Fulton, the then Minister of Justice, made a speech in Winnipeg to the Canadian Credit Men's Trust Association during which he stated that the *Bankruptcy Act* was under review. He asked for all interested persons to make submissions in respect of the Act to him through the Superintendent of Bankruptcy. The speech was widely publicized. From the time that this request was made until the appointment of this committee, some 1,200 specific suggestions contained in a great number of briefs were, in fact, made which indicated wide concern over the functioning of the bankruptcy system in this country. A list of the major briefs is contained in appendix "A" to this report.

0.0.04 The first task of the committee was to review all of the suggestions for changes which had been made. When this was done, a questionnaire was sent to all official receivers and registrars in Canada. We are indebted to them for the care that they took in supplying us with the information requested. Copies of these questionnaires are attached as appendices "B" and "C".

0.0.05 At a later stage, we supplemented the information we had received from the briefs and the questionnaires by interviewing a number of judges, registrars, official receivers, trustees, lawyers and law teachers, principally in Montreal and Toronto.

0.0.06 Several submissions and briefs were also submitted to us after our appointment. In many instances, the individuals concerned or representatives of the organizations who submitted the briefs asked to appear before the committee and, in all cases, they were given the opportunity to do so.

0.0.07 As the work of the committee progressed, we had occasion to invite a number of persons with special qualifications to prepare memoranda on

particular subjects. These papers were of great assistance to us and we desire to express our thanks to those who furnished them.

0.0.08 It was important to widen our perspective and to understand the premises inherent in the Canadian bankruptcy system dictated by our tradition and law. To this end, we examined with some care the bankruptcy systems of other jurisdictions. We particularly studied the Bankruptcy Acts and related legislation of England, France, Australia and the United States of America. We also examined, but not in the same detail, the bankruptcy systems of Switzerland, West Germany, Belgium, the Netherlands and Italy.

0.0.09 The committee visited the United Kingdom, France, Switzerland, Belgium, the United States of America and Australia. In these countries, we were concerned with learning how their bankruptcy systems functioned, the problems they had and the research which was being done. In many cases, while studying the systems of these countries, we had been attracted by particular features. In almost every case where we recommend incorporating features of the Bankruptcy Acts of other countries, we had the opportunity through these visits to discuss these features with specialists in the countries concerned. We gratefully acknowledge and record our appreciation to the many judges, lawyers, trustees, law teachers, court and administrative officials of these countries who went out of their way to assist us in our research.

0.0.10 It is appropriate that special mention be made of the assistance which we received from many officials and other bankruptcy specialists in the United States of America. It is only natural that Canada should be particularly concerned with the United States bankruptcy experience. Both are North American countries. The social conditions, economies and constitutional provisions relating to bankruptcy and insolvency of both countries are similar in many respects. Moreover, many of the problems Canada faces in bankruptcy first appeared in the United States.

0.0.11 The problem of fraudulent bankruptcies was discussed with officials of the United States Department of Justice and the Federal Bureau of Investigation. Other discussions were had with officials of other Departments of Government and, from time to time, with the Chief of the Division of Bankruptcy, Administrative Office of the United States Courts. On two occasions, members of the committee met with members of the staff of the Brookings Institution which is currently engaged in a study of "Bankruptcy Problems" in the United States. Members of the committee have also been privileged to attend, as guests, the annual conferences of the National Conference of Referees in Bankruptcy and the National Bankruptcy Conference for the past four years. This has been a most valuable experience and has greatly assisted us in our study.

0.0.12 We have attempted to review the principal articles contained in the major law reviews of Canada, England and the United States for the past twenty-five years or more. Several studies on problems relating to bankruptcy in other countries were made available to us, often on a confidential basis. We also had

the benefit of a number of books and monographs relating to consumer credit and wage earners bankruptcies published in the last few years.

0.0.13 In order to obtain a full and complete view of the working of the present legislation, we reviewed, section by section, all of the Canadian statutes relating to bankruptcy and insolvency.

0.0.14 The present *Bankruptcy Act,* enacted in 1949, is based upon the *Bankruptcy Act* of 1919 which in turn was based upon the *Bankruptcy Act* of England, first enacted in its present form in 1883. The 1949 Act was first introduced in Parliament by Bill A5 in 1946. Basically, the 1949 Act, although enacted in the post-war period, had its origins and was drafted just prior to and during the 1939-1945 war. The changes made in the Act at that time related for the most part to procedural matters. In addition, sections of the Act were almost completely rearranged. In retrospect, the *Bankruptcy Act,* (1949) may be criticized, not so much for perpetuating many archaic or meaningless sections, but, for what it did not contain. It should be remembered, however, that many of the defects which now appear in the *Bankruptcy Act* first became apparent after the great expansion of consumer credit following the war and the advent of the "Affluent Society". In this respect, we have the advantage of hindsight over a period of great social change which was not available to the draftsmen of the 1949 Act who could but only guess the shape of the post-war society and economy.

0.0.15 We were initially of opinion that any necessary changes to the legislation could be done by way of amendment only. We soon became strongly of opinion that the proposed revisions should be by way of a new comprehensive Act. The changes we recommend to the existing legislation are many and far reaching. Unless a new comprehensive Act is enacted, the result would be confusing and it would be difficult in many cases to ascertain the law with certainty.

0.0.16 The work in drafting the Bill is well advanced. As there will be several fundamental changes to the law, we are of the opinion that a report should be published now to focus attention on the broad principles that are guiding us so as to give interested persons the opportunity to study the recommendations and thereby be able to view the Bill, when published, with an understanding of its underlying principles.

Part I

The Evolution of the Bankruptcy System

INTRODUCTION

1.0.01 The history of how man has dealt with the problems of insolvency goes back to ancient times. It is instructive to study that history before considering how the problem should be approached under present day conditions. An understanding of the many refinements and improvements made to the legislation in the past to adapt it to changing conditions may broaden our perspective in considering present problems. This history, we briefly relate in Chapter 1.

1.0.02 Bankruptcy and insolvency legislation also has a long history in Canada. The various developments of the legislation in our country constitute as many efforts to adapt the law to changing circumstances. The brief history contained in Chapter 2 highlights the important phases of the development of the Canadian legislation since Confederation.

1.0.03 The short outline of the present Canadian bankruptcy system contained in Chapter 3 is designed to provide some background against which could be read the rest of the report and, especially, our proposals for changes.

1.0.04 Finally, it is important, in formulating proposals for changes to the bankruptcy and insolvency legislation, to appreciate any constitutional constraints that may exist. This is especially so in Canada where the legislative authority of the State is divided between two levels of governments. Chapter 4 attempts to outline the constitutional position, as it may affect the problems under consideration.

CHAPTER I

THE HISTORY OF BANKRUPTCY

1.1.01 *An Expanding Concept*: The long history of bankruptcy has been one of an expanding concept. From the harsh and merciless treatment of debtors, the law, through many stages, has come to recognize that, while there may be fraudulent debtors from whom society must be protected, an honest bankrupt is not a contradiction of terms. Upon this cornerstone has been built the modern law of bankruptcy.

1.1.02 In primitive societies, the debtor's lot was hard. There was no exception to the rule that he must pay his debts in full. If he could not pay with his property, he paid with his person.

1.1.03 *The Code of Hammurabi*: Written more than 4000 years ago, the Code of Hammurabi, King of Babylon, contained several sections concerning the relations between debtors and creditors. According to this Code, the creditor was entitled to levy a "distress" or "pledge", called a *nipûtum*, if the debt was not paid when it became due. It was not necessary for the creditor to first obtain judgment, but he was penalized if he wrongfully levied a distress. While oxen of the plough and grain were exempted from seizure, the debtor's wife, a child or a slave could be brought as *nipûtum* to the creditor's house. There they were put to work until the debt was satisfied. In addition to the *nipûtum*, the Code considered the case where the debtor voluntarily surrendered a dependant into bondage by selling him, with or without a right of redemption, to a merchant or to the creditor himself. The position of the dependant in the house of his new master seems to be similar to that of the *nipûtum*, but, in the case of a wife or child, the servitude came to an end after three years service. Finally, if the debt of the creditor was not satisfied one way or another, there seems little doubt that the debtor could be adjudicated to him as a bond-servant.[1]

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[1] G.R. DRIVER and John C. MILES, *The Babylonian Laws*, Oxford, The Clarendon Press, 1952, vol. 1, pp. 208-221.

1.1.04 *The Law of Ancient Greece*: By the end of the 7th Century, B.C., in Athens, the new class of mercantile capitalists virtually owned the entire peasant class with mortgages on nearly every small holding in Attica. The peasants could not resist foreclosures on their lands and on their persons, which often were included in their pledges. The poor were in a state of bondage to the rich, both themselves, their wives, and their children. The political situation was critical. In order to avert a revolution, Solon cancelled all existing mortgages and debts, released debtors from bondage and made illegal those contracts in which a person's liberty was pledged.[2]

1.1.05 *The Roman Law*: When, in the middle of the 5th Century, B.C., Rome decided to codify its laws, it sent three commissioners to Greece to study the laws of Solon. The code that resulted is known as the *Law of the Twelve Tables.* Contrary to the spirit of the reform of Solon, the Roman jurists maintained the execution against the person. After the fulfilment of certain formalities, the unpaid creditor had the power to seize the debtor himself. This seizure, called *manus injectio*, gave the creditor authority to bring the debtor to his home and keep him in chains for sixty days. During this period, the debtor, still the owner of his property and a Roman citizen, could try to settle his debts with his creditor. To allow for the possibility of a ransom being paid, the creditor was required to take him three times to the market place giving notice of the amount of the debt each time. Finally, if at the end of sixty days, the creditor was not fully paid, he could, it would seem, put the debtor to death or sell him into foreign slavery. According to certain modern writers, the creditors could even divide between them the body of the debtor. If this was so, there is no proof that such an inhuman treatment was ever applied. It must also be noted that the *paterfamilias* could, as was the case under the *Hammurabi Code*, in order to avoid his slavery, raise money by leasing out the services of the members of his family. In Roman law, this is known as *mancipium*[3]. During the centuries that followed the promulgation of the *Law of the Twleve Tables*, the severity of the *manus injectio* was progressively reduced. By the end of the Republic, the unpaid creditor could still imprison the debtor or make the debtor work for him in satisfaction of the debt but he could no longer put him to death or sell him into slavery.

1.1.06 As Ihéring pointed out, early Roman law only recognized execution against the person:

> Ce qu'un individu a acquis au prix de son corps et de sa vie, ou à la sueur de son front, semble devenir une partie de lui-même. Quiconque entame cette propriété doit payer; s'il ne peut restituer, son propre corps répond de ce qu'il a enlevé.[4]

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[2] G. GLOTZ, *La Cité Grecque*, Paris, La Renaissance du Livre, 1928, p. 140;
W. SEAGLE, *Men of Law*, New York, The MacMillan Company, 1947, p. 38;
M. I. ROSTOVTZEFF, *A History of the Ancient World*, 2nd ed., vol. 1, The Orient and Greece, Oxford, The Clarendon Press, 1945, C. 15.

[3] Raymond MONIER *Manuel Elementaire de Droit Romain*, 6th ed., Paris, Editions Domat-Montchrestien, 1947, Tome I, pp. 31-32, 146-150 and 224; W.W. BUCKLAND, *A Text Book of Roman Law from Augustus to Justinian*, 3rd ed., Cambridge, The University Press, 1963, pp. 618-623.

[4] R. IHERING, *L'Esprit du Droit Romain*, Meulenaere's translation, 3rd ed., Paris, vol. 1, 1886, p. 136.

This was the rule under Roman law until the end of the Republic, when the *Edict of the Praetor* alleviated the harshness of the old quiritarian law. About that time, one praetor developed a method of execution against property known as *venditio bonorum*. This fundamental reform, for the first time, established a link between the assets and the liabilities of a person. Moreover, this was in the nature of a procedure for the collective execution against the property of an insolvent or recalcitrant debtor. To quote W.W. Buckland, "It is in effect the Roman equivalent of bankruptcy proceedings."[5]

1.1.07 Thus, by the end of the Republic, Roman law recognized two methods of execution, one against the person and the other against property. The debtor could, however, by the time of Augustus, avoid execution against his person by making a *cessio bonorum,* that is to say, by surrending to his creditors everything he owned. About three centuries later, the *cessio bonorum* was not available to debtors who had squandered their property or concealed it from their creditors. According to an imperial ordinance of the year 379, this procedure was only allowed when the insolvency of the debtor was due to an act of God. Under Justinian, the use of the *cessio bonorum* had become so widespread that the *Corpus Juris* scarcely mentions imprisonment for debt.[6]

1.1.08 *The Italian Cities:* As trade and the use of credit developed, the ordinary law of debtor and creditor became inadequate to cope with the problem of the insolvent trader. Towards the end of the Mediaeval Ages, the Italian cities attempted to deal with this problem and new concepts, such as the "act of bankruptcy"[7] were developed by legal writers of the time. It is from the Italian *bancarupta* that the word "bankrupt" is derived. It may be literally translated as "bank broken" or "bench broken". The allusion is said to be the custom of breaking the table of a defaulting tradesman.

1.1.09 *The French Law:* In France, and elsewhere in Europe, the Roman law, in its ultimate stages, became the basis of the law merchant. The French *Ordinance of 1673* is celebrated as being the first great codification of the law merchant in France. This Ordinance and the *Code de Commerce de 1807* had great influence in most civil law jurisdictions of the world.

1.1.10 *The English Law:* In England, one of the first insolvency statutes was enacted in 1351[8]. In an attempt to promote commercial integrity, it provided that, if any merchant of the Company of Lombard Merchants acknowledged himself bound in a debt, the Company should answer for it. Apparently, this was by reason of the fact that some of these merchants had, in the past, left the country without paying their debts.

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[5] Raymond MONIER, *op. cit.*, pp. 171-174; W.W. BUCKLAND, *op. cit.*, p. 644.

[6] Raymond MONIER, *op. cit.*, pp. 149, 171 and 202, W.W. BUCKLAND, *op. cit.*, p. 645, Fritz SCHULZ, *Classical Roman Law,* Oxford, The Clarendon Press, 1951, p. 214.

[7] Israel TREIMAN, *Acts of Bankruptcy: A Mediaeval Concept in Modern Bankruptcy Law,* (1938), 52 Harv. L.R., p. 189.

[8] 25 Edw. III, U.K.S. 1351-2, C. 23.

1.1.11 At Common Law, a creditor has to resort to a very expensive, lengthy and cumbersome procedure to obtain an attachment of his debtor's property. Execution cannot be obtained against a debtor's entire estate but only against the property described in the writ. If there was a plurality of creditors, they took the property of the debtor in the order of their attachments. The race was to the swift. The rule was "first come, first served".[9]

1.1.12 The first Bankruptcy Statutes provided a summary method for the collective execution of all of the debtor's property, both movable and immovable. They stressed the rights of creditors. The only concern shown in respect of the debtor was that he should surrender all of his property and that no fraud on his part should go undetected and unpunished. Under the first of these statutes, the property was liquidated and distributed "to every of the said creditors a portion, rate and rate alike, according to the quantity of their debts."[10] The preamble of this statute stated: "where divers and sundry persons craftily obtaining into their own hands great substance of other Mens (sic) Goods, do suddenly flee to Parts unknown, or keep their Houses not minding to pay or restore to any (sic) their Creditors, their Debts and Duties, but at their own Wills and Pleasures Consume the Substance obtained by credit of other Men for their own Pleasure and delicate Living against all Reason, Equity and good Conscience."

1.1.13 Although the English *Bankruptcy Act* of 1542 was directed against any debtor who attempted to defeat his creditors by fraudulent means, the Act of 1571[11] restricted bankruptcy to those who were engaged in trade. This distinction was to be maintained for almost 300 years. A debtor who was not in trade and who could not pay his debts was imprisoned until some person paid them for him.

1.1.14 The first English Act showing concern for the rehabilitation of the debtor was enacted in 1705 in the reign of Anne.[12] A debtor who was a merchant could get a discharge of all his debts owing at the time of his bankruptcy provided he surrendered all of his property and conformed to the other provisions of the statute. However, the legislator remained very much aware of the continuing problem of the fraudulent debtor. So, while being given new privileges, the debtor had to be free from fraud and submit himself to the control of the Court. Evidence of the concern of the legislator that debtors might abuse the privileges given to them was the severity of the penalty for a debtor who did not strictly comply with the law. The penalty, in the past, had been to stand in the pillory or have an ear cut off. The new penalty was hanging. This penalty applied, for example, if the bankrupt failed to surrender himself to

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[9] W.S. HOLDSWORTH, *History of English Law*, Vol. VIII, London, p. 232.

[10] 34 & 35 Hen. VIII, U.K.S., 1542, C.4.

[11] 13 Eliz. I, U.K.S., 1571, C.7.

[12] 4 & 5 Anne, U.K.S., 1705, C. 17.

the court, committed perjury on his examination or fraudulently concealed his assets.[13]

1.1.15 In the middle of the 18th Century, Sir William Blackstone, commenting on the Law of England, had this to say about bankruptcy:

> The Laws of England, more widely, have steered in the middle between both extremes: providing at once against the inhumanity of the creditor, who is not suffered to confine an honest bankrupt after his effects are delivered up; and at the same time taking care that all his just debts shall be paid; so far as the effects will extend. But still they are cautious of encouraging prodigality and extravagance by this indulgence to debtors; and therefore they allow the benefit of the laws of bankruptcy to none but actual traders; since that set of men are, generally speaking, the only persons liable to accidental losses, and to an inability of paying their debts, without any fault of their own. If persons in other situations of life run in debt without the power of payment, they must take the consequences of their own indiscretion, even though they may meet with sudden accidents that may reduce their fortunes: for the law holds it to be an unjustifiable practice, for any person but a tradesman to encumber himself with debts of any considerable value. If a gentleman, or one in a liberal profession, at a time of contracting his debts, has a sufficient fund to pay them, the delay of payment is a species of dishonesty, and a temporary injustice to his creditor: and if, at such time, he has no sufficient fund, the dishonesty and the injustice is the greater. He cannot therefore, murmur, if he suffers the punishment which he has voluntarily drawn upon himself. But in mercantile transactions, the case is far otherwise. Trade cannot be carried on without mutual credit on both sides: the contracting of debts is therefore here not only justifiable, but necessary. And if by accidental calamities, as by the loss of a ship in a tempest, the failure of brother traders, or by the non-payment of persons out of trade, a merchant or tradesman becomes incapable of discharging his own debts, it is his misfortune and not his fault. To the misfortunes, therefore, of debtors, the law had given a compassionate remedy, but denied it to their faults: since at the same time that it provides for the security of commerce, by enacting that every considerable trader may be declared a bankrupt, for the benefit of his creditors as well as himself, it has also to discourage extravagance, declared that no one shall be capable of being made a bankrupt, but only a trader, nor capable of receiving the full benefit of the statutes, but only an industrious trader.[14]

1.1.16 James A. Bayard expressed similar views when speaking in the United States Congress in 1803 against the repeal of the first United States *Bankruptcy Act*, modelled on the English Act:

> . . . the commercial world cannot exist without such an act. Its necessity arises from the nature of trade and does not belong to other classes of citizens. It is founded on the principle that commerce is built on great credits and great credits produce great debts. Owing to the risks arising from these and other circumstances, the most diligent and honourable merchant may be ruined without committing any fault. Not so as to the other classes of citizens; either the cultivators of the soil, the mechanics, or those who follow a liberal profession. They live on the profit of their labor, not on profits derived from credit.[14A]

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[13] "The punishment of death for not surrendering, or submitting to be examined, for concealing property, was first introduced by the 4 and 5 Anne, continued by the 5 Geo. I, and afterwards by the 5 Geo. 2, C. 30; and it was not until the reign of his present majesty that the penalty was changed to the milder one of transportation." *Eden on Bankruptcy Laws*, 382. The last reference to the statute of "his present majesty" is 1 Geo. IV, U.K.S., 1821, C. 115.

[14] W. BLACKSTONE, *Commentaries on the Laws of England*, Book II, Oxford, the Clarendon Press, 1766, pp. 473-4.

[14A] UNITED STATES, *Annals of Congress*, 1802-1803, 2nd Session, 7th Congress, p. 547

1.1.17 In the early part of the 19th Century, a number of statutes were passed for the relief of insolvent debtors who were not engaged in trade and therefore could not be made bankrupt. Originally, the insolvency acts provided only for the release from imprisonment of the debtor. He was not released of his debts and remained liable for their repayment. Later legislation provided for the discharge of persons who were imprisoned for their debts if they surrendered all of their goods for the benefit of their creditors. In 1812[15], the laws relating to insolvency were administered by a court of record known as the Court for the Relief of Insolvent Debtors. By the *Bankruptcy Act* of 1861[16], which made persons other than traders subject to bankruptcy law, this Court was abolished and its jurisdiction transferred to the Court of Bankruptcy. In 1869, by the *Bankruptcy Repeal and Insolvent Court Act*[17], all insolvency statutes theretofore existing were extinguished. Imprisonment for debt was abolished altogether, except in the case of a dishonest person who could pay his debts but refused to do so. The legal distinction between bankruptcy and insolvency was thus all but eliminated.

1.1.18 In the history of bankruptcy, there is much experimentation concerning who should liquidate and supervise an estate. In 1831, for example, the English legislation provided for the joint administration by official assignees and assignees chosen by the creditors. In 1869, the system of administration, at the insistence of the trading community, reverted to a system of creditor liquidation. The creditors chose the trustee who was supervised by a committee of inspectors also chosen by the creditors. Abuses soon arose, however, particularly in regard to the solicitation of proxies, which often permitted a minority of creditors to control and manipulate the administration of an estate in their interests to the prejudice of the majority of creditors.

1.1.19 It was recognized in England that the system of creditor control over the administration of a bankruptcy estate, as provided by the 1869 Act, had failed. The English *Bankruptcy Act of 1883* devised a new system of joint official and creditor control. Although minor amendments have been made to this Act, the system of administration, that it created, has not changed in any material respect. When Joseph Chamberlain, the then President of the Board of Trade, spoke on the second reading of the Bill for the 1883 Act, he explained the philosophy of his new legislation as follows:

> He, (Joseph Chamberlain), asked the House to keep in mind two main, and, at the same time, distinct objects of any good Bankruptcy Law. Those were, firstly, in the honest administration of bankrupt estates, with a view to the fair and speedy distribution of the assets among the creditors, whose property they were; and, in the second place their object should be, following the idea that prevention was better than cure, to do something to improve the general tone of commercial morality, to promote honest trading, and to lessen the number of failures. In other words, Parliament had to endeavour, as far as possible, to protect the salvage, and also to diminish the number of wrecks.

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[15] 52 Geo. III, U.K.S., 1812, C. 165.
[16] 24 & 25 Vic. U.K.S., 1861, C. 135.
[17] 32 & 33 Vic. U.K.S., 1869, C. 83.

> His next point was that, with regard to those two most important objects, there was only one way by which they could be secured and that was by securing an independent and impartial examination into the circumstances of each case; and that was the cardinal principle of this Bill . . . What happened when a bankruptcy took place which might easily cause misery to thousands of people and bring ruin on many homes? It was treated as if it were entirely a matter of private concern, and allowed to become a scramble between the debtor and his advisers – who were often his confederates – on the one hand, and the creditors on the other. Meanwhile, the great public interests at stake in all these questions were entirely and absolutely ignored, as there was nobody to represent them, and the practice which was followed in the case of other calamities was, in this case, entirely absent. In the case of accidents by sea and by land – railway accidents, for instance – it was incumbent upon a Government Department to institute an inquiry. There were inquiries in the case of accidents in mines, and of boiler explosions, and sad as those disasters were, they did not, in the majority of cases, cause so much misery as a bad bankruptcy, which brought ruin to many families by carrying off the fruits of their labour and industry . . .
> Now, it would be seen that the provision which he had described (a description of duties and responsibilities of the official receiver, the office of which was first created by this Bill) constituted a system which he thought they might fairly call a system of official inquiry, and which went on all fours with a similar system in the matters of accident to which he had referred. He did not think that without some such limited officialism as this any satisfactory inquiry was even possible. No investigation could be worth anything unless it was conducted by an independent and impartial officer . . .[18]

1.1.20 *Conclusion:* In this chapter we have examined how the insolvent debtor was treated under the laws of several of the civilizations of the ancient world and, in particular, under the law of Rome. Among the modern bankruptcy systems, the only one here studied in any detail was the English system, as it was upon it that the Canadian legislation was modelled.

1.1.21 Over the years, the principles underlying the English Insolvency and Bankruptcy Law changed considerably. While, at the outset, the legislation was of a purely criminal nature, this character has been progressively attenuated as the legal treatment given to debtors became more and more humane. The former "creditors acts", very strict with debtors, eventually recognized the necessity to give the honest and unfortunate debtor a chance to rehabilitate himself. This chance was given to insolvent traders as early as 1705 and, about one century later, extended to all debtors. Finally, after a great deal of experimentation in the field of bankruptcy administration, England opted for a compromise between official and creditor control. As will be seen in the next chapter, the element of officialism in the English system is much greater than in its Canadian counterpart.

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[18] J. CHAMBERLAIN, *Hansard's Parliament Debates* (England), 3rd series, Vol. CCLXXVII, p. 817, March 19, 1883.

CHAPTER 2

THE CANADIAN LEGISLATION SINCE CONFEDERATION

1.2.01 *Principal Milestones*: In the hundred years since Confederation, the following Statutes constitute the important milestones of bankruptcy and insolvency legislation:

1869:	*The Insolvent Act of 1869*	32-33 Vic., Can. S. 1869, C. 16
1875:	*The Insolvent Act of 1875*	38 Vic., Can. S. 1875, C. 16
1880:	*An Act to repeal the Acts Respecting Insolvency now in force in Canada*	43 Vic., Can. S. 1880, C. 1
1882:	*An Act respecting Insolvent Banks, Insurance Companies, Loan Companies, Building Societies and Trading Corporations,* later renamed the *Winding-Up Act* (for insolvent companies)	45 Vic., Can. S. 1882, C. 23
1889:	*The Winding Up Amendment Act, 1889* (extended to solvent companies)	52 Vic., Can. S. 1889, C. 32
1919:	*The Bankruptcy Act*	9-10 Geo. V, Can. S. 1919, C. 36
1923:	*The Bankruptcy Act Amendment Act, 1923* (companies prohibited from making proposals without previously being adjudged bankrupt; office of custodian created; office of official receivers created)	13-14 Geo. V, Can. S. 1923, C. 31
1932:	*The Bankruptcy Act Amendment Act, 1932* (office of Superintendent created)	22-23 Geo. V, Can. S. 1932, C. 39
1933:	*The Companies' Creditors Arrangement Act, 1933*	23-24 Geo. V, Can. S. 1932-33, C. 36
1934:	*The Farmers' Creditors Arrangement Act, 1934*	24-25 Geo. V, Can. S. 1934, C. 53
1943:	*The Farmers' Creditors Arrangement Act, 1943*	7 Geo. VI, Can. S. 1943, C. 26
1949:	*Bankruptcy Act, 1949*	13 Geo. VI, Can. S. 1949 (2nd Session) C. 7

1953:	*An Act to Amend the Companies' Creditors Arrangement Act, 1933* (act restricted to arrangement including an arrangement between a company and its bondholders).	1-2 El. II, Can. S. 1952-53, C. 3
1966:	*An Act to Amend the Bankruptcy Act*	14-15 El. II, Can. S. 1966-67, C. 32

1.2.02 *The First Insolvency Legislation After Confederation*: The Acts of 1869 and 1875 applied only to insolvent traders. From 1874 to 1878 there was a serious depression in Canada resulting in many commercial failures. This caused much public resentment particularly in the rural areas of the country which led to the enactment of *The Insolvency Acts Repeal Act* in 1880. The following quotations from the debates in the House of Commons indicate something of the public opinion of the time and the reasons for the repeal. The anger directed at those who appeared to be acting fraudulently still has a timeliness:

> Mr. Colby: Whatever may have been the necessity of the law when it was passed, I think that now it is unquestionably a fact that it has outlived its usefulness and that public opinion is definitely settled and has declared itself in a way that is unmistakeable, in favour of an immediate and summary repeal of the Act . . . (the law) became rather a means of escape for the dishonest and designing debtor than a mere means of relief for the honest and unfortunate debtor . . . experience has also shown in this country, and in other countries I believe, that the rapacity of assignees, the dishonesty of debtors, the greed of some creditors, the inattention of others, have thwarted the beneficient intentions of the law; and instead of there being an economical and honest administration of assets, the practical operation of the law has been characterized by a wasteful extravagance, and too often by a dishonest administration. I think it is unmistakeably the case in this country where the law has been a long time on the Statute-Book, that it has tended to the demoralisation of trade, and to lower the standard of commercial morality. It has tended to recklessness in trading and in living to extravagance. It has tempted many persons, wholly unsuited for business, to risk their fortune in business enterprises that were little understood by them. The whole effect of the law in recent years has been unfortunate and disastrous. I think, sir, that it is the sentiment of the people of this country, generally, that it has tended, in some considerable degree, if not to create, at all events to aggravate, the commercial distress which has unhappily prevailed in this country.[1]
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> Mr. Sproule: . . . Public opinion has been too strong against the continuance of these laws, which apply to one class of the community only, to prevent their continuance upon the Statutes of our country. They have only held out inducements for parties so disposed to shape their affairs in such a way, even to change from one line to another, so as to enable them to take advantage of the Act, and pay their debts with twenty, thirty or forty cents on the dollar. I believe it is generally recognized that there is not more than one honest trader out of every three or four who have taken the benefit of that act since it was placed on the Statute-Book. It seems strange that if the law was so beneficial, it should have been made applicable only to commercial people, and that all professional men, labourers and mechanics, and all the agricultural classes of the community should be entirely left out from the benefits supposed to accrue from that law . . .[2]

1.2.03 By a coincidence that appears not to be accidental, the *Bill to Repeal the Insolvency Acts* was read for the third time on March 4, 1880, while on March 5, 1880, assent was given, in Ontario, to "An *Act to Abolish Priorities of and Amongst Execution Creditors.*"[3] In the discussion in the House of

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[1] CANADA *House of Commons Debates*, 1880, 2nd Session, 4th Parliament, Vol. 1, pp. 102 and 103.

[2] *Ibid*, p. 107.

[3] 43 Vic., Ont. S. 1880, C. 10. This Act is now known as the *Creditors' Relief Act.*

Commons, it was said that the Ontario Bill, which was similar to the law prevailing in Quebec, would provide for the just and equitable distribution of estates and the hope was expressed that other provinces would enact similar legislation.

1.2.04 *The Winding-Up Act*: It was soon found that, without an *Insolvency Act*, there was no convenient way to wind up insolvent companies. Boards of Trade, in most of the large cities, passed resolutions requesting new legislation. In 1882, the *Insolvent Banks, Insurance Companies and Trading Corporations Act*, later to be known as the *Winding-Up Act*, was enacted.

1.2.05 In some countries, such as England and Australia, the *Bankruptcy Act* applies only to individuals and there is other legislation for the liquidation of insolvent companies. With the existence of the *Winding-Up Act,* this dichotomy could have developed in Canada. However, when the *Bankruptcy Act* of 1919 was enacted, it applied to both individuals and corporations. From 1919 until 1966, there were, in effect, two separate Acts in competition with each other relating to the insolvency of limited liability companies. These two Acts differ in substance and technique. In bankruptcy, for example, the property of the bankrupt vests in the trustee; under the *Winding-Up Act*, title to the property of the company remains in the company, but its control and management are taken from the directors and placed in the liquidator. The *Bankruptcy Act* binds the Crown, while the *Winding-Up Act* does not. Under the *Bankruptcy Act*, an act of bankruptcy must be proved to obtain a receiving order, while, under the *Winding-Up Act*, a winding-up order may be obtained if the debtor is insolvent or deemed to be insolvent. Neither banks, insurance companies nor railway companies may be liquidated under the *Bankruptcy Act*, but they may be wound up under the *Winding-Up Act*. The *Bankruptcy Act* is characterized by an administration, for the most part, controlled by creditors, while, under the *Winding-Up Act*, the administration is controlled by the court. This duality is restricted by the amendments to the *Bankruptcy Act* in 1966, which provide in effect that the *Bankruptcy Act* should take precedence over the *Winding-Up Act*. Thus, now, where a petition for a receiving order or an assignment is filed under the *Bankruptcy Act*, in respect of a corporation, the *Winding-Up Act* does not extend or apply to that corporation.[4]

1.2.06 *The Period from 1880 to 1919*: During the thirty-nine years when there was no federal bankruptcy or insolvency legislation relating to individuals, the only relief available to insolvent individuals was through provincial legislation. There were, in Quebec, articles 763-780 of *The Code of Civil Procedure* and, in the other provinces, the Assignment and Preferences Acts. The first of these Acts was an *Act Respecting Assignments for the Benefit of Creditors* passed by the Ontario Legislature in 1885, some five years after enacting what is now *The Creditors' Relief Act*.

1.2.07 Under provincial legislation, an insolvent debtor makes an assignment of his property to an authorized trustee licensed by the province. The authorized

[4] *An Act to amend the Bankruptcy Act*, 14-15 Eliz. II, Can. S. 1966, C. 32, s. 169A.

trustee is then required to liquidate the estate under the supervision of inspectors. For this, he is paid a fee from the debtor's estate. What characterizes provincial legislation, and since 1919, distinguishes it from the *Bankruptcy Act* is that a creditor cannot force a debtor to make an assignment; once an assignment is made, there is no provision in the legislation permitting a debtor to make a composition with his creditors and a debtor does not receive a release of his debts or a discharge.

1.2.08 *The 1919 Bankruptcy Act*: By 1917, there was considerable agitation across the country in support of the enactment of a national *Bankruptcy Act*. A committee of the Canadian Bar Association was created to draft such an act. This, in turn, disturbed some businessmen and authorized trustees licensed by the provinces. They felt that an act drafted by lawyers would provide for some form of court controlled administration instead of the provincial system of creditor control whereby estates were liquidated by the authorized trustees under the supervision of inspectors. One of the largest firms of authorized trustees, the Canadian Credit Men's Trust Association, retained Mr. H.P. Grundy, K.C. of Winnipeg, and instructed him to draft a Bill based upon creditor control and retaining the essential features of the provincial Assignments and Preferences Acts.

1.2.09 The Bill, based upon Mr. Grundy's draft, was first introduced in the House of Commons on March 27, 1918 as a war measure. On the motion for first reading, it was said:

> Mr. Jacobs. . . I think that I can claim for this Bill that it is essentially a war measure at this particular time. We must be prepared when the war comes to a close, to be able to handle the situation which is bound to arise in this country as a result of the long continued struggle and of the readjustments which must be made . . . By this measure it is proposed that the courts shall carefully scrutinize the business dealings and the business relations of traders, and shall make a distinction – shall separate the sheep from the goats. When the court is of the opinion that a debtor has been obliged to assign through misfortune, he shall be given the necessary relife. If, on the other hand, it should be found in scrutinizing his affairs, that he wrecked his own business wilfully, then, of course, he should receive no relief whatever.[5]

The Bill, later referred to a special committee and then reintroduced in the House of Commons during the following session, [6] was enacted in 1919.

1.2.10 *The Office of the Custodian Created in 1923*: It had been hoped that the system of administration established by the 1919 Act and based upon the practice prevailing under the provincial Assignments Acts would prevent the occurring of the abuses that had helped to discredit the old Insolvency Acts. It was soon found, however, that most of the business under the new Act was not going to the experienced organizations of trustees that had efficiently handled most of the business under the provincial Assignments Acts. The work of a trustee attracted many unqualified and inexperienced persons, and, as there was then not enough business, this resulted in many trustees openly soliciting business and often lead to collusive and inefficient administration of estates.

[5] CANADA, *House of Commons Debates*, 1918, 1st Session, 13th Parliament, Vol. 1, p. 206.

[6] *Ibid*, p. 563.

1.2.11 In an attempt to rectify the abuses surrounding the appointment of trustees, particularly in voluntary assignments where the debtor was nominating his own trustee, the office of custodian was created in 1923. In many respects, the custodian fulfilled several of the functions of the official receiver in England until the first meeting of the creditors. The custodian was in effect the first trustee in every estate. He had to take possession of the property of the debtor and was responsible for its safekeeping until the appointment of the trustee at the first meeting of creditors. In practice, it soon developed that the custodian was invariably appointed trustee. As a result, the office of the custodian served no useful purpose and was ultimately abolished in 1949.

1.2.12 *The Office of Superintendent of Bankruptcy created in 1932*: The lack of safeguards surrounding the appointment of trustees encouraged the activities of dishonest trustees. There were scandals involving inefficient and collusive liquidations by incompetent and untrustworthy trustees. The supervision of trustees by creditors was ineffectual and the demand grew for some form of government supervision.[7]

1.2.13 At the Annual Meeting of the Canadian Credit Men's Trust Association Ltd., in 1927, attention was called to the office of "Accountant of Court" created under the *Bankruptcy Act* of Scotland. The Accountant, who was appointed by the court on the recommendation of the Crown, had the responsibility to examine the charges and conduct of trustees and inspectors in every proceeding.

1.2.14 In 1929, the late Lewis Duncan, Q.C., an acknowledged bankruptcy specialist, after comparing the English, French and United States systems, suggested that there was a need in Canada for an adequately staffed bankruptcy department with offices at strategic centres.[8]

1.2.15 In 1932, the office of the Superintendent was created. It was contemplated that the Superintendent would provide an independent, impartial and official supervision of trustees administering estates under the *Bankruptcy Act*. Except for the increased investigatory powers given to it in 1966, the office of the Superintendent has remained unaltered and compares with that of the Inspector General in Bankruptcy established in England in 1883.

1.2.16 *The 1949 Bankruptcy Act:* The present Canadian *Bankruptcy Act* was enacted in 1949. The intention of the new Act was said to be "to clarify and simplify the legislation". The following extract from Hansard, when the Bill was

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[7]CANADIAN CREDIT MEN'S TRUST ASSOCIATION LTD., Minutes of the 17th Annual Meeting, p. 143.

[8]In a letter to Robert H. Thayer, an investigator working on the report known as the *Donovan Report*. This letter can be found at p. 59 of the appendix to the *Report, Bankruptcy Administration in Canada*, which can be found at p. 237 of the said *Donovan Report*, whose full title is: THE JOINT COMMITTEE OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK, THE NEW YORK COUNTY LAWYERS' ASSOCIATION AND THE BRONX COUNTY BAR ASSOCIATION, *Report submitted to the Hon. Thomas D. Thacher, Judge of the United States District Court for the Southern District of New York*, on March 22, 1930, by William J. Donovan, Counsel to the Petitioners.

first introduced in the Senate, explains the history of the Bill and the principal changes:

> Hon. J. Gordon Fogo: Honourable senators, it has sometimes been said that legislation in Canada is passed hastily and that those interested and the public in general are not given an opportunity to study its provisions. I do not think that can be said of this Bill F, which appears to have had a rather checkered career. This, I believe, is the fourth time that the bill has been introduced in this honourable House. It was first brought down in the year 1946, in a somewhat different form from the present measure, and was laid over for study for a period during which representations concerning it were made. Subsequently, in 1948, it came up again in a revised form. And, as most honourable senators will remember, it was introduced for a third time at the first session of this year, but unfortunately, owing to early dissolution, consideration of it was not completed. The present bill, I am informed, with very few exceptions, is practically identical with the bill that was before the Senate last session . . . The bill provides a more orderly arrangement of subjects and the language in many sections of the Act has been simplified. One or two of the more notable changes should be mentioned. The bill reinstates a provision which was in the *Bankruptcy Act* of 1919. During the period from 1919 to 1923 the Act contained a provision whereby an insolvent person could make a proposal to his creditors without making an assignment or having a receiving order made against him, and thereby suffering the stigma of bankruptcy. The bill now provides that an insolvent person may make such a proposal without going through the procedure of bankruptcy.
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> A further change which has been generally accepted as an improvement is a code for the administration of small estates in an economical and inexpensive manner. This section of the bill covers estates with assets of $500 or less, and provides a simplified procedure for their administration.
>
> One other notable innovation of this bill is found in sections 127 to 129, which deal with the discharge of bankrupts. Under the existing legislation it has been necessary for a bankrupt, after the administration was completed, to apply to get his discharge. For various reasons, whether because the debtor did not know he was entitled to do this, or for other reasons, it was not customary for bankrupts to apply to their discharge. Following legislation in other countries–I think in the United States, and perhaps in Australia–this bill incorporates what might be regarded as an automatic application for discharge, because the occurring of the bankruptcy through assignment or receiving order in the first instance is also treated as an application for discharge. The debtor of course has to satisfy the court that he qualifies before he gets his discharge, and the conditions are laid down.
>
> To move on quickly and in a very summary way: there are other miscellaneous provisions which might be mentioned. The new bill vests a greater measure of control in the creditors and inspectors. The powers of the superintendent have been made more explicit . . . The remuneration of trustees has been increased; that is, the maximum remuneration has been enlarged from 5 to 7½ per cent . . . The office of the custodian is eliminated . . . [9]

1.2.17 *The 1966 Amendment:* During the fifties and early sixties, there was an increasing number of complaints about fraudulent bankruptcies. The complaint was also made that the investigatory machinery was not adequate to cope with the problem. As a result, the *Bankruptcy Act* was amended in 1966 so as to give the Superintendent wider powers of investigation. He may now investigate offences under any Act of Parliament, whether they have occurred before or after bankruptcy.

1.2.18 Many other significant amendments were made in 1966. One relates to non-arms' length transactions, and enables trustees better to deal with the transactions entered into by a debtor to the prejudice of his creditors. Part X of the *Bankruptcy Act* was also enacted. It provides for a system of orderly

[9] CANADA, *Debates of the Senate,* 1949, 2nd Session, 21st Parliament, p. 97.

payment of debts under the supervision of the courts, but it is effective only in provinces where the Lieutenant Governor in Council has requested the Governor in Council to proclaim it in force.

1.2.19 *The Companies' Creditors Arrangement Act:* Prior to 1914, when most of Canada's financing was done in England, the practice, in issuing securities, was to follow English precedents. As a consequence, almost all trust deeds during this period contained clauses permitting a majority of debenture holders to vary the terms of a trust deed. Sometime later, in the twenties, when financing in the United States became more common, such provisions were no longer included in a great many trust deeds as they were not at that time usual in the United States. When the depression came, many companies needed to be reorganized. Often, to the embarrassment of the directors, it was found that the trust deeds did not contain provisions permitting reorganization by agreement. As a result, without the existence of enabling legislation, there was no way by which such companies could be reorganized.

1.2.20 Some of the reasons for which companies may wish to reorganize are to permit

(1) the extension of the maturity of debentures, with or without increasing the interest rate, when the marketing conditions make the refunding difficult, undesirable or impossible;
(2) a new encumbrance to rank ahead of existing debentures;
(3) the sale of assets to a new company subject to the same debenture;
(4) the release of mortgaged assets to secure new securities;
(5) the trustee to release part of the mortgaged property either unconditionally or upon terms;
(6) the waiver of minor defects.

1.2.21 *The Bankruptcy Act* of 1919 permitted a limited company to make a proposal to its creditors before a receiving order was made or an assignment filed. There was, however, little protection for the creditors. In many parts of Canada, complaints arose that debtors were bribing their creditors and using fraudulent means to secure their creditors' consent to a proposal and thus to avoid bankruptcy.[10] As a result of the 1923 amendments to the *Bankruptcy Act,* no debtor was permitted to make a proposal unless he had first been declared bankrupt and the first meeting of creditors had been held. The requirement that there first be a bankruptcy before a proposal could be made met with mounting criticism and, as a consequence, the *Companies' Creditors Arrangement Act* was enacted in 1933 to permit a company to make, outside of bankruptcy, an arrangement with its secured and unsecured creditors. Broadly speaking, this Act was modeled upon provisions of the English *Companies Act.*

1.2.22 When the *Companies' Creditors Arrangement Act* received its first reading in the House of Commons, the Honourable C.H. Cahan, the then Secretary of State, said:

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[10] *The Donovan Report,* p. 25. (For full title, see *supra,* p. 36, note 8).

> (The *Bankruptcy Act* and the *Winding-Up Act)* provide for the liquidation of the company under a trustee in the one case and under a liquidator in the other and the almost inevitable result is that the organization of the company is entirely disrupted, its good will depreciated and ultimately lost and the balance of its assets sold by the trustee or the liquidator for whatever they will bring. There is no mode or method under our laws whereby the creditors of a company may be brought into court and permitted by amicable agreement between themselves to arrange for a settlement or compromise of the debts of the company in such a way as to permit the company effectively to continue its business by its reorganization . . . At the present time, some legal method of making arrangements and compromises between creditors and companies is perhaps more necessary because of the prevailing commercial and industrial depression and it was thought by the government that we should adopt some method whereby compromises might be carried into effect under the supervision of the court without utterly destroying the company or its organization without loss of good will and without forcing the improvident sales of its assets.[11]

1.2.23 *The Companies' Creditors Arrangement Act* worked well and gave general satisfaction to investors and to companies with secured indebtedness who wished to make arrangements with their creditors. There were, however, abuses of the Act by insolvent companies that used it, instead of the *Bankruptcy Act,* to make arrangements with their unsecured creditors. The *Companies' Creditors Arrangement Act* was never intended for this purpose, as it did not provide an appropriate procedure to give sufficient protection to unsecured creditors against false or misleading statements by the company concerning its affairs, thereby inducing them to accept proposals not in their best interests.

1.2.24 "Debenture holders" did not, however, have to rely solely on this Act for protection. The investing public had other facilities available. Most debentures gave the indenture trustee wide powers to intervene in the affairs of the debtor upon certain conditions. Institutional investors and underwriters that have large blocks of debentures on their hands or in their portfolios would, as a rule, also intervene in order to prevent any serious abuse.

1.2.25 In 1946, Bill A5, the first of the four bills mentioned by Senator Fogo, (*supra* 1.2.16) proposed to bring all corporate reorganizations under a new *Bankruptcy Act* and to repeal the *Companies' Creditors Arrangement Act.* No provision, however, was contained in the Bill for the special problems of the investor creditor, such as the position of the holder of a bearer debenture; for example, there was no provision for representation orders and service was required to be made on all creditors, which, in many cases, is clearly impossible.

1.2.26 The former Dominion Mortgage and Investments Association opposed the repeal of the *Companies' Creditors Arrangement Act.* It suggested, instead, that the abuses concerning it could be remedied if its use were confined to debtors with outstanding issues of debentures and the proposed arrangement affected the debentures or some of them. No further action was taken on Bill A5, although many of the features contained in it were later incorporated in the *Bankruptcy Act* of 1949.

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[11]CANADA. *House of Commons Debates,* 1932-1933, 4th Session, 17th Parliament, Vol. 4, p. 4090.

1.2.27 In 1953, the *Companies' Creditors Arrangement Act* was amended, as originally suggested by the Dominion Mortgage and Investments Association, so as to restrict its application to a debtor company that had an outstanding debenture issue and wished to make a proposal with the debenture holders. When the Honourable Stuart S. Garson, the then Minister of Justice, moved the second reading of the Bill, he said:

> The *Companies' Creditors Arrangement Act* was passed in 1933. At that time, the *Bankruptcy Act* did not contain adequate provisions for an arrangement between a corporate debtor and its creditors by which the corporate debtor, by getting an extension of its liabilities, could liquidate them, avoid bankruptcy and retain its identity. In other words, if they were going to come under the *Bankruptcy Act* at all they had to go into bankruptcy. The *Companies' Creditors Arrangement Act* was passed to enable these corporate debtors to make an extension of that sort without going into bankruptcy. But it appeared that the *Companies' Creditors Arrangement Act* was passed without too careful regard for the protection of the trade creditors of mercantile concerns going into an arrangement of that sort under this act, and since the arrangements under the *Companies' Creditors Arrangement Act* were not in the hands of an official trustee as under the *Bankruptcy Act,* it was found in a number of cases that the trade creditors' interests were frequently and seriously prejudiced.
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> As a consequence a Bill was introduced in the house in 1938 to repeal the *Companies' Creditors Arrangement Act* altogether. But this was strongly opposed by the Dominion Mortgage and Investment Association because, amongst other reasons, the laws of the United States prohibit the sale of securities unless there is in existence in relation to them appropriate legislation to enable a majority of stockholders to effect a re-organization of the company if the circumstances seem to demand it. Of two conflicting groups who were in disagreement in respect of the legislation, one was this Dominion Mortgage and Investment Association which desired the retention of the *Companies' Creditors Arrangement Act* in order to deal with financial companies whose creditors were secured by a trust deed containing a provision for a trustee for such creditors. On the other hand, was a group of businessmen who were either trade creditors themselves or were opposed to the trade creditors being mulcted under the same act in respect or mercantile liabilities.
>
> The introduction of the present bill is agreeable to both these groups. When the bill was before the other place, I am informed that both groups appeared and were agreeable to its provisions. With the passage of this bill it will leave companies that have complex financial structures, and a large number of investor creditors, able to use the *Companies' Creditors Arrangement Act* for the purpose of re-organization. Moreover they will be able to use it efficiently; because as a rule the terms of their own trust deed provide for a trustee of the creditors whose business it will be to look after their interests, a provision of which almost invariably [is] absent in the case of the mercantile creditors. The mercantile companies will be able to use the provision of part III of the new revised *Bankruptcy Act,* which, unlike the *Bankruptcy Act* in force in 1933, has a provision whereby companies may apply for an extension to work out their affairs without incurring the stigma of bankruptcy.
>
> Moreover, this provision of part III of the *Bankruptcy Act* requires the appointment of a trustee in bankruptcy who will look after the interests of the mercantile creditors and who will have supervision of the bankruptcy branch, which proceedings under the *Companies' Creditors Arrangement Act* do not now have.
>
> I do not think there can be great opposition to this because it seems to be an arrangement—the arrangement set out in this bill—which adequately protects the position of the investor creditor, and is not at all unfair to the corporate debtor in either case.[12]

1.2.28 Since its 1953 amendment, the *Companies' Creditors Arrangement Act* has been seldom used. This is by reason of the fact that its application has

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[12] CANADA, *House of Commons Debates,* 1952-1953, 7th Session, 21st Parliament, Vol. 2, p. 1269.

been restricted and that trust indentures usually now provide machinery for the contractual reorganization of the financial affairs of the debtor company.

1.2.29 *The Farmers' Creditors Arrangement Act:* This was emergency legislation designed to cope with the economic emergency of the depression. It was considered to be temporary legislation. The preamble to the Act, which explained its purpose, stated:

> Whereas in view of the depressed state of agriculture the present indebtedness of many farmers is beyond their capacity to pay; and whereas it is essential in the interest of the Dominion to retain the farmers on the land as efficient producers and for such purpose it is necessary to provide means whereby compromises or rearrangements may be effected of debts of farmers who are unable to pay.

1.2.30 The then Prime Minister, the Right Honourable R.B. Bennett, in the initial debate on the Bill, said:

> Bankruptcy proceedings have been regarded with some suspicion not only by farmers themselves, but also by those with whom the farmers deal and the question of whether or not the general provisions of the *Bankruptcy Act* should apply is, of course, an open one. We do not propose, therefore, that the ordinary provisions of the *Bankruptcy Act* should apply, but that for the present–hoping that it will not be for a long period–there should be appointed a special receiver rather than an official receiver such as we now have whose duty will be to assist in arriving at a composition, adjustment or settlement of the outstanding difficulties that confront the farmer.[13]

1.2.31 In 1943, the Judicial Committee of the Privy Council held that the *Debt Adjustment Act,* 1937 (Alberta) was legislation in relation to bankruptcy and insolvency and was *ultra vires.*[14] This decision served to confirm the decisions of the lower courts on the Saskatchewan *Debt Adjustment Act* and likewise threw grave doubts upon the Manitoba *Debt Adjustment Act.* As a result of this decision, the *Farmers' Creditors Arrangement Act.* of 1934 was repealed in 1943 and a new Act under the same name was enacted in its place. On the second reading of the Bill, it was said by the Honourable J.L. Ilsley, the then Minister of Finance:

> ... As a result (of the decision of the Judicial Committee of the Privy Council), representations were made to the Dominion Government by various delegations, including a delegation from the Saskatchewan conference of representatives of the three prairie province governments and farmers' organization and representatives of the mortgage and investment companies and insurance companies, as well as other individual creditors and debtors. Various representations were made to the government from private citizens of the prairie provinces, including a considerable number of farmers who represented the point of view of both debtors and vendors of land. The need for a means of adjusting the old and onerous debt loads of depressed farmers in the west was admitted, but various opinions were advanced as to the best method of doing this. I think it is fair to say that general emphasis was put on the importance of safeguarding the credit of western agriculture and ensuring the necessary flow of new capital for the development of the industry ...
>
> Experience has shown certain limitations on the *Farmers' Creditors Arrangement Act,* 1934 and it was urged upon the government by representatives of both debtors and creditors that these defects should be remedied by new legislation under the bankruptcy jurisdiction of the dominion. Manitoba pressed for the extension of the Act, or similar

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[13] CANADA, *House of Commons Debates,* 1934, 5th Session, 17th Parliament, Vol. 10, p. 3639.

[14] *Reference re the Debt Adjustment Act, 1937 (Alberta);* A.G. for *Alberta* v. *A.G. for Canada et al,* (1942-43) 24 C.B.R. 129.

legislation, to that province as well as to Alberta and Saskatchewan, and indeed, the Saskatchewan conference suggested that there be enacted legislation which would provide for continuous adjustment of farm debts.

The government has given careful consideration to these representations and to the question of the best way of meeting the problem that existed in the three prairie provinces without doing irreparable harm to the credit of western agriculture. After careful deliberation, the government reached the decision that it was inadvisable at this time to reopen the fundamental issues of the western debt problem. To embark upon legislation so highly controversial during the stress of war when the energies of parliament and the country, as a whole, are being taxed by immediate war emergencies, was felt to be unwise . . .

. . . The government, however, felt it desirable to meet the immediate need of preventing farmers from being dispossessed of their lands when food production was of such vital importance to the nation and to that end an order-in-council was passed following the Privy Council decisions, that provided that in any action by a mortgagee for foreclosure, or by a vendor under an agreement for sale or cancellation of the agreement, the court may stay the action, postpone the payment of any moneys due, vary or extend any order previously made with a view to retaining on the land during the state of war now existing an efficient and industrious farmer and at the same time protecting all other persons having any interest in the land of the debtor.

At the same time the study which has been made of the operation of the *Farmers' Creditors Arrangement Act,* 1934 and of the representations received earlier this year, has induced us to introduce the bill which is now before the house. This bill is designed to rescind the 1934 Act and substitute for it an act which will continue, with important changes the system of farm debt adjustment which has, on the whole, worked successfully in the past.[15]

In the same debate, The Right Honourable J.G. Diefenbaker, in discussing the operation of the Act in Saskatchewan, gave some indication of the extent of the problem when he said:

> . . . Up to April of 1940, there were 5094 proposals made under the act since 1935; secured debts were reduced by $18,547,051 and unsecured debts by $1,926,819 during that period, or an average reduction of 41.9 per cent per farm. In the Province of Saskatchewan there were 142,000 farmers with a debt load in excess of $482,000,000 . . .[16]

1.2.32 The Act, which is required to be "read and construed as one with the *Bankruptcy Act*"[17], provides a summary procedure whereby a farmer may make an arrangement with his creditors. Where the farmer and his creditors cannot agree upon the terms of an arrangement, the court is empowered to formulate an arrangement and impose it upon the creditors. In such cases, the secured debt of a farmer can be reduced without the consent of the creditor. Although the Act, which is far reaching and drastic, had the immediate result of helping the hard pressed prairie farmers, there is reason to believe that in the long run the Act worked to the detriment of the farmer. Investors became reluctant to lend money on farm mortgages by fear that a part of the loan might be wiped out through an arrangement under the Act. The long term result of the Act was that almost the only money loaned on farm mortgages came from the Farm Loans Board, created at the time the *Farmers' Creditors Arrangement Act* was enacted.

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[15] CANADA, *House of Commons Debates,* 1943, 4th Session, 19th Parliament, Vol. 5, p. 5039.

[16] Ibid., p. 5041.

[17] *The Farmers' Creditors Arrangement Act,* 1943, 7-8 Geo. VI, Can. S. 1943, C. 26, S. 2(2).

1.2.33 The *Farmers' Creditors Arrangement Act,* as a practical matter, cannot now be used as it relates only to farmers who have incurred two-thirds of the total amount of their debts before December 15, 1943. No proceedings under this Act have been reported since 1959.

1.2.34 *Other Legislation:* The *Bankruptcy Act,* The *Winding-Up Act,* The *Companies' Creditors Arrangement Act* and *The Farmers' Creditors Arrangement Act* are the principal but not the only federal statutes relating to bankruptcy and insolvency. There are, for exemple, special provisions in the *Bank Act* and the *Quebec Savings Bank Act* in reference to insolvent banks. *The Exchequer Court Act* and the *Railway Act* contain sections relating to insolvent railways. In addition to the *Winding-Up Act* by which the winding up of insurance companies is primarily governed, there are special sections concerning insolvent insurance companies in the *Canadian and British Insurance Companies Act* and the *Foreign Insurance Companies Act.*

1.2.35 *Conclusion:* At the end of this brief description of how the bankruptcy and insolvency system developed in Canada, there are a number of comments that come to mind.

1.2.36 Although, at the outset, the legislation was almost entirely borrowed from England, in the course of time, amendments were made to the original legislation to better adapt it to Canadian conditions and special statutes were passed to meet particular problems. Little attempt was made, however, to integrate new legislation with the existing legislation or to make a single comprehensive Act. The result has been a multiplicity of statutes and systems which often lead to inequity and inefficiency.

1.2.37 With the multiplicity of systems, the debtor and the creditor sometimes have the choice of the system under which to proceed and, under certain certain circumstances, they can fare better under one system than another. A creditor, for example, may be better protected or may have a higher priority for a dividend under one system than another. Similarly, the penalty provisions applicable to debtors may vary.

1.2.38 Many corporations may be liquidated under either the *Winding-Up Act* or the *Bankruptcy Act.* There are transactions that may be set aside as fraudulent preferences under one of these Acts, which could not be set aside, as such, under the other. However, since the 1966 amendments to the *Bankruptcy Act,* the *Winding-Up Act* does not apply to a corporation, where a petition is filed under the *Bankruptcy Act.* While the opportunity of a debtor or creditor to elect to take proceedings under the *Winding-Up Act,* and thus forestall proceedings under the *Bankruptcy Act,* has been reduced, inequities are still possible. The majority of creditors, for example, may wish to take proceedings under the *Winding-Up Act* to reach a creditor who has received a preference that may be set aside as fraudulent under the *Winding-Up Act,* but not under the *Bankruptcy Act.* The creditor who is alleged to have obtained a fraudulent preference, or a creditor friendly to him, may effectively block the proceedings under the *Winding-Up Act* by making a petition under the *Bankruptcy Act.*

1.2.39 There are situations, however, where no choice is given to the debtor or the creditors as to which statute may be used. A number of statutes apply in whole or in part, for example, to particular debtors, such as banks, insurance companies and railways. This situation may also lead to inequity as both debtors and creditors, under the particular statutes, may, without good reason, fare differently than those who come within the provisions of other statutes.

1.2.40 Moreover, in spite of the multiplicity of systems and statutes, there are a number of debtors whose affairs cannot be liquidated under existing federal legislation. The non-trading corporations, for example, would be in that category. It is not clear, either, whether any of this legislation applies to the winding-up, by reason of their insolvency, of some corporations, such as provincial trust companies and certain building societies.

1.2.41 Finally, the existing legislation may also be criticized for being, to a considerable degree, either rudimentary or out-dated. Much of it was designed when social and commercial conditions were very much different than what they are today. In other cases, legislation designed to meet a particular emergency survived long after the emergency had passed and the conditions changed. The procedure for the liquidation of insolvent railways is a good example of rudimentary legislation. Under present conditions, as a practical matter, special legislation would probably be required to effectively liquidate a railway company by reason of its insolvency, as existing legislation is silent in respect to many matters of importance. The *Farmers' Creditors Arrangement Act* is an example of special legislation inspired by a national emergency that has been long out of date, but which has never been repealed, brought up to date or incorporated into the principal statute.

CHAPTER 3

THE PRESENT CANADIAN LEGISLATION

1.3.01 Having briefly traced the history of Canadian bankruptcy and insolvency legislation and how the system developed, we pause in this chapter to shortly describe the system and the manner in which it functions.

I Proceedings Under the Bankruptcy Act

1.3.02 *Voluntary and Involuntary Bankruptcies*: There are two methods by which liquidation of a debtor's property may be initiated under the *Bankruptcy Act.* Firstly, a debtor may voluntarily enter bankruptcy by making an assignment of his property. Secondly, a debtor may be forced into bankruptcy by the petition of a creditor. A debtor who has filed a proposal under the Act may also be forced into bankruptcy if the creditors do not give their approval or if the Court either does not ratify or annuls the proposal.

1.3.03 *Petition by Creditor*: If the debtor has committed an "act of bankruptcy", a creditor may petition for a receiving order. An "act of bankruptcy" may be regarded as an act that raises a presumption that the debtor is either unable to pay his debts or is attempting to avoid their payment. The "act of bankruptcy" most frequently used is that the debtor ceased "to meet his liabilities generally as they become due". The petition is filed with the registrar in bankruptcy. If the debtor consents or if he does not oppose the petition, the registrar may make a receiving order that has the effect of adjudicating the debtor bankrupt. If the petition is opposed, it is heard by a judge.

1.3.04 *Interim Receiver*: At any time after the filing of a petition, but before a receiving order is made, the court may appoint a licensed trustee to be interim receiver of the property of the debtor, if it is "necessary for the protection of the estate". The interim receiver usually owes his appointment to the recommendation of the petitioning creditor. If a receiving order is subsequently made, the interim receiver, in most cases, is appointed the trustee of the estate.

1.3.05 *Assignment by Debtor*: A voluntary bankruptcy is commenced by the debtor filing, with the official receiver, a formal assignment of his property with the name of the assignee in blank. It must be accompanied by a sworn statement showing the property of the debtor, a list of his creditors with their addresses, and the amount owed to each. The official receiver must then select a trustee by reference to the wishes of the most interested creditors "if ascertainable at the time", and complete the assignment by inserting therein, as grantee, the name of the trustee. In practice, the trustee is chosen by the debtor who, in the majority of cases, has approached the trustee, before the assignment is filed, to ascertain whether or not he would act as trustee. The trustee, before accepting the appointment, satisfies himself that the proceeds from the realization of the estate will be at least sufficient to secure the payment of his fee. In "no asset cases", cash deposits or third party guarantees are usually required by the trustee.

1.3.06 *Official Receivers*: The principal duties of the official receivers are to accept and file assignments, to appoint trustees on assignments, to examine all debtors as to their conduct, the causes of their bankruptcy and the disposition of their property, to fix the amount of the bond to be filed by trustees in both voluntary and involuntary bankruptcies and to preside over, or nominate someone else to preside over, the first meeting of creditors.

1.3.07 Each Province of Canada is a bankruptcy district, some of which are divided into bankruptcy divisions. For each division, one or more official receivers may be appointed by the Governor in Council. In Vancouver, Calgary, Edmonton, Toronto, Ottawa, Hull, Montreal and Quebec City, where the volume of bankruptcies is greater than in other parts of the country, full-time federal civil servants have been appointed as official receivers. Elsewhere, the official receivers are usually provincial civil servants, often court officials.

1.3.08 In Canada, the official receiver is not a receiver in the generally accepted meaning of the word. In England, the official receiver is a true receiver. There, in the interval between the making of a receiving order, which is in the nature of an interim order, and the order adjudging the debtor bankrupt, which is the final order, the official receiver is given control of the debtor's property. The debtor, during this interval, is not deprived of the ownership of his property, but is not entitled to deal with it.

1.3.09 *First Meeting*: At the first meeting of creditors, the appointment of the trustee is affirmed or another is substituted in his place. One or more, but not exceeding five inspectors, are appointed. Such directions are given to the trustee as the creditors may see fit with reference to the administration of the estate. There are seldom subsequent meetings of creditors as the inspectors are considered to represent them.

1.3.10 *Inspectors*: The first meeting of inspectors takes place, as a rule, at the conclusion of the first meeting of creditors. The inspectors discuss with the trustee how the estate is to be administered. All major decisions of the trustee relating to the liquidation of the property of the debtor must be authorized by them. Each inspector is entitled to be repaid his actual and necessary travelling expenses

incurred in and about the performance of his duties and may be paid a fee ranging from $3.00 to $10.00 per meeting, depending upon the size of the estate.

1.3.11 *The Trustee*: Only a trustee who has been licensed by the Superintendent of Bankruptcy, with the approval of the Minister of Consumer and Corporate Affairs, may be appointed the trustee of an estate. He is an officer of the Court and subject to its direction. His main responsibility is to collect the estate of the debtor, to liquidate it and to distribute the proceeds to the creditors. He does this under the direction and supervision of the creditors who, usually, act through the board of inspectors.

1.3.12 *The Role of the Creditors*: The underlying principle of the *Bankruptcy Act* is that the creditors should control the administration of an estate in bankruptcy. The theory of creditor control is that, since the assets of the bankrupt are liquidated for the benefit of the creditors, they are in the best position to look after their own interest. As much power as is reasonably possible to give is given to the creditors. They appoint the trustee and may substitute one trustee for another, within the limits of the system requiring trustees to be licensed. In the administration of the estate, the trustee must consider the directions of the creditors, so long as they are not contrary to the Act. Not only is the trustee bound by these instructions in order for his actions to be valid, but, to avoid being subject to personal liability, he generally requires specific authorization for all that he does. In addition, the trustee is required to report to the creditors, at their request, concerning his administration.

1.3.13 *Property Available for Creditors*: All the property of a debtor at the date of his bankruptcy, or that may be acquired by, or devolved on, him before his discharge, is available for the payment of his debts. The only exception is property that, as against the bankrupt, is exempt from execution or seizure under the laws of the province within which the property is situated and within which the bankrupt resides.

1.3.14 The trustee is required to go beyond mere appearances in identifying and taking possession of the property of the bankrupt. Certain transactions entered into within varying suspect periods may be examined and avoided or reviewed under the *Bankruptcy Act* or the applicable provincial legislation. Examples of such transactions include: (a) certain types of gifts made by a debtor within one year prior to becoming bankrupt; the suspect period is extended to five years where the debtor, at the time of the gift, was unable to pay his debts in full without the aid of the property given away; (b) certain transfers of property, where the intention of the debtor was to defraud his creditors; (c) transfers of property by a debtor to creditors with a view to giving those creditors a preference, where the debtor becomes bankrupt within three months thereafter; the period is extended to twelve months, if the debtor and the creditors are related persons; (d) transactions entered into within twelve months prior to bankruptcy, by a debtor, with persons dealing with him otherwise than at arm's length, may be reviewed and, where it is found that the consideration given or received by the bankrupt was conspicuously greater or less than the fair market value of the property or services concerned in the transaction, judgment may be given to the trustee for the difference.

1.3.15 *Claims Against the Estate:* All persons to whom the bankrupt is indebted, as of the date of bankruptcy, may prove a claim against the estate of the bankrupt. The trustee may disallow the claim or allow it, in whole or in part, subject to an appeal to the court. A secured creditor may prove a claim, if he surrenders his security to the trustee for the general benefit of the creditors. Where the creditor realizes his security, he may prove for the balance due to him, after deducting the net amount realized. Instead of realizing his security, the secured creditor may assess the value of his security and claim for the difference. The trustee may redeem the security at the value assessed by the creditor or, if the secured creditor takes no action, the trustee may redeem the security by paying the debt.

1.3.16 *Distribution of Property*: The trustee is required to pay dividends in the course of realizing the property as funds become available, subject to the retention of such sums as may be necessary for the costs of administration. Certain claims are paid in priority to others. After payment of the costs of administration, these claims must be paid in full before a dividend may be paid to the ordinary creditors. The creditors who have a priority include those to whom are owed: (a) wages and salaries for services rendered within three months prior to bankruptcy, to the extent of five hundred dollars in each case; (b) municipal taxes for a two-year period, if they are not secured by a preferential lien on real property, provided they do not exceed the value of the property against which the taxes are imposed; (c) arrears of rent for a period of three months prior to bankruptcy and accelerated rent for three months, if permitted by the lease, provided the total amount does not exceed the realization from the property on the premises under the lease; and (d) claims of the Crown in right of Canada or of any province.

1.3.17 The claims of certain creditors are postponed until the claims of all other creditors are satisfied. These creditors are: (a) a spouse or former spouse of the bankrupt, in respect of a claim for wages, salary, commission or compensation in connection with the business of the bankrupt; (b) a creditor who entered into a reviewable transaction with the bankrupt unless, in the opinion of the trustee or the court, it was a proper transaction; and (c) certain persons claiming under a marriage contract.

1.3.18 *Disabilities of Bankrupts*: The bankruptcy has the effect of imposing a number of legal disabilities upon the bankrupt until his discharge. Some of the most important of these are that: (a) he may not engage in trade or business without disclosing, to all persons with whom he enters into a business transaction, that he is an undischarged bankrupt, (b) he may not obtain credit, for a purpose other than the supply of necessaries for himself and family, to the extent of five hundred dollars or more, without disclosing that he is an undischarged bankrupt; (c) he may not be a director of a limited liability corporation; and (d) he may not be a senator.

1.3.19 *Discharge of Bankrupt*: The court has a wide discretion to grant a discharge to a bankrupt. It may refuse a discharge, suspend it for any period, or require the bankrupt, as a condition of his discharge, to pay such moneys, or comply with such other terms, as the court may direct. However, no corporation may obtain a discharge unless it satisfies the claims of its creditors in full.

1.3.20 The discharge releases the bankrupt of all the claims of his creditors in the bankruptcy, except: (a) a fine or penalty imposed by a court; (b) a debt arising out of a bail bond; (c) a debt or liability for alimony, maintenance, or support of a spouse or child, living apart from the bankrupt; (d) certain debts incurred by fraud; (e) a debt for goods supplied as necessaries of life; and (f) a dividend that a creditor would have been entitled to receive on a provable claim not disclosed to the trustee, except where the creditor had notice of the bankruptcy.

1.3.21 *Discharge of Trustee*: When a trustee has completed the administration of the estate, he is required to apply for his discharge. The court may grant him a discharge if he has accounted, to the satisfaction of the inspectors and the court, for all property that came to his hands. The discharge has the effect of releasing the trustee from all liability in respect of any act done or default made by him in the administration of the property of the bankrupt, and from all liability in relation to his conduct as trustee. For his services, the trustee, unless the court otherwise orders, or the creditors otherwise agree, is entitled to a remuneration not exceeding seven and one-half per cent of the amount realized. In calculating the trustee's remuneration, however, payments made to secured creditors are not taken into account.

1.3.22 *Bankruptcy Offences:* In order to ensure their full co-operation in the administration of estates, the *Bankruptcy Act* imposes upon bankrupts many duties with penalties for their non-performance. Bankrupts are obliged, for example, to make discovery of and deliver their property to the trustee, to prepare a statement of their affairs, to attend the first meeting of creditors and to examine the correctness of all proofs of claims. The Act also provides that the doing of certain things by the bankrupt, such as a fraudulent disposition of property and the making of a false entry in a statement, constitute an offence. Penalties are also imposed upon inspectors for accepting anything in addition to their fees. There are also a number of offences directed at trustees who abuse their position.

1.3.23 *Proposals*: A debtor, before or after becoming bankrupt, may make a proposal to his creditors. If the proposal is accepted by a majority in number and three-fourths in value of the creditors present at a meeting of creditors and subsequently ratified by the court, it is binding upon all creditors with provable claims. In the case of a proposal made after bankruptcy, the approval of the court operates to annul the bankruptcy and to revest in the debtor, or such other person as the court may direct, the property of the bankrupt, unless the terms of the proposal otherwise provide.

1.3.24 *The Orderly Payment of Debts*: Part X of the Act, which authorizes consolidation orders to facilitate the orderly payment of debts, was enacted in 1966. It only applies in those provinces that request the federal government to proclaim it in force in the province concerned. To the present, the Part has been proclaimed in force in British Columbia, the Prairie Provinces, Nova Scotia and Prince Edward Island. It is not, however, in operation in Prince Edward Island, as the provincial government has not as yet taken the necessary steps to have a Court designated for the purpose of the Part.

1.3.25 In any province where Part X is in force, a small debtor who is not in business and who is unable to pay his debts as they mature may apply to the court for a consolidation order. While an order is outstanding, and so long as the debtor is not in default in making the payments required by the order, no process may be issued against the debtor in respect of any debt to which the consolidation order applies. However, a secured creditor may, at any time, elect to rely on his security.

1.3.26 *The Superintendent of Bankruptcy*: Official control of the bankruptcy process is exercised by the Superintendent of Bankruptcy. He is the head of the Bankruptcy Branch of the Department of Consumer and Corporate Affairs. Among other responsibilities, he must investigate allegations that offences have been committed under the *Bankruptcy Act*, where it appears that they would not otherwise be investigated. He also has the responsibility to supervise the administration of all estates to which the Act applies. To do this, he may intervene, as a party, in any matter or proceeding in Court. Every petition for a receiving order is served upon the Superintendent. He may thereby get early notice of a matter that might require investigation. In the same way, every bill of costs of a solicitor is served upon him and, if he considers it advisable, he may intervene on the taxation. The Superintendent also examines every statement of receipts and disbursements and the final dividend sheet prepared by the trustee when the administration of an estate is completed. The Superintendent's comments upon these documents are considered by the Court when the trustee's accounts are passed. It is also the responsibility of the Superintendent to receive applications for licences, and to make recommendations to the Minister for or against the granting of such applications.

II Proceedings Under the Winding-Up Act

1.3.27 A winding-up order may be made in respect of any insolvent company. When an order is made, a liquidator is appointed by the court. The property of the debtor corporation is liquidated by the liquidator under the supervision of the court. In the course of liquidation, the debtor corporation may propose to make a compromise or arrangement with its creditors. If an arrangement is accepted by a majority in number representing three-fourths in value of the creditors and subsequently sanctioned by the court, it is binding upon all the creditors, the liquidator and contributories of the company. Special provisions are applicable to the liquidation of banks and insurance companies, which are excepted from the provisions of the *Bankruptcy Act*. Where proceedings have been instituted under the *Bankruptcy Act* in respect of a corporation, the *Winding-Up Act* does not apply to that corporation. With court control of the administration, the procedure, under the *Winding-Up Act*, necessitates more frequent applications to the court than that under the *Bankruptcy Act*.

III Proceeding Under the Companies' Creditors Arrangement Act

1.3.28 An arrangement may be made under this Act by a company, only if it has outstanding an issue of debentures and the arrangement includes terms binding the company and the debenture holders. Where an arrangement is proposed, an application is made to the court to direct a meeting of the class or classes of creditors concerned. The court, in its discretion, may also require a meeting of the shareholders. An arrangement is binding upon all of the creditors in the classes concerned, where it has been agreed by a majority in number representing three-fourths in value of the creditors and sanctioned by the court.[1]

IV Proceedings Under the Farmers' Creditors Arrangement Act

1.3.29 The provisions permitting a farmer to make an arrangement under this Act can no longer be invoked, except in very exceptional cases, as a condition precedent is that two-thirds of the farmer's debt must have been incurred before December 15, 1943.[2]

[1] For a further discussion as to the operation of the *Companies' Creditors Arrangement Act*, see *supra*, 1.2.19 to 1.2.28.

[2] For a discussion as to the operation of the *Farmers' Creditors Arrangement Act*, see *supra*, 1.2.29 to 1.2.33.

CHAPTER 4

BANKRUPTCY AND THE CONSTITUTION

1.4.01 Before recommending any legislative changes, it is necessary to describe the constitutional grant of power in Canada with respect to bankruptcy and insolvency. In doing so, we shall not discuss whether this grant of power is appropriate or not, as this is beyond our terms of reference. Our aim is simply to ascertain the limits of the respective legislative powers of the federal and provincial governments. As the Canadian Constitutional Law is complicated and difficult to summarize, we shall do no more than review some of the most important constitutional cases. We think it appropriate, however, to begin our study by referring briefly to the constitution of some other federal states.

1.4.02 *Comparative Constitutional Law:* Of the various countries visited by the Committee, three have a federal constitution: Switzerland, Australia and the United States. In all these countries, the federal legislature has legislative authority over bankruptcy and insolvency.

1.4.03 In the case of Switzerland, article 4 of the Constitution gives the federal Parliament legislative authority over bankruptcy and execution of money judgments. However, at the time when the constitution went into effect, the Cantons retained the power to legislate on these matters until they were dealt with by federal legislation. Today, it is generally agreed that the federal legislature has made full use of its power and that, consequently, there are no more unfilled gaps within which the Cantons can still legislate[1].

1.4.04 In Australia, the federal Parliament, according to the interpretation given to the Constitution by the courts, does not have general legislative authority over the incorporation of companies.[2] For the same reasons, it is doubtful that it

[1] Amos J. PEASLEE, *Constitutions of Nations,* rev. 3rd ed., The Hague, Martinus Nijhoff, 1968, vol. 3, p. 64; Jean-François AUBERT, *Traité de Droit constitutionnel suisse,* Dalloz, 1967, vol. 1, pp. 261 to 263.

[2] It should be noted that the *Australian Capital Territory* has authority to create, regulate and liquidate companies within its territory. It is in the exercise of this authority that the A.C.T. has adopted *The Companies Ordinance 1962-1963.*

possesses such authority over the winding-up of solvent companies. However, in article 51, the Constitution expressly grants to the federal Parliament legislative power over bankruptcy and insolvency. The federal Parliament has passed legislation in the exercise of this power, but section 7 of the *Bankruptcy Act, 1966* makes it impossible for corporations to go into voluntary or forced bankruptcy. The result of this is that only natural persons can be adjudged bankrupt and that companies, even if they are insolvent, can only be wound up under the law of the States. It seems, nonetheless, that the Australian Parliament would have authority to extend the scope of the law on bankruptcy to include insolvent corporations[3]. As for the possibility of applying the law of the States in the field of bankruptcy, the matter is discussed as follows in a recent treatise:

> The provisions of the various Bankruptcy Acts or Insolvency Acts in existence in the States or Territories prior to 1st August, 1928 (the date when the first Commonwealth Bankruptcy Act 1924-1927 commenced) can sometimes be important by virtue of s. 9 of the Commonwealth Act. This section provides that the Act does not affect any State or Territory laws providing for "matters not dealt with expressly or by necessary implication in this Act.
>
> Obviously a State Parliament is not empowered by s. 9 to provide for an alternative set of proceedings and merely by giving them a different name, to establish a jurisdiction covering the same ground. If the Commonwealth Act provides any way by which a matter may be adjudicated or makes any rules for proceedings in the particular circumstances, it prevails over any State legislation on the subject. Thus it is only a court exercising jurisdiction under the Commonwealth Act that is entitled to decide whether a deed of arrangement between a debtor and his creditors is valid. But if there is no provision in the Commonwealth Act that governs the matter and a State Act governing another branch of law has such a provision the latter is applicable.
>
> There is indeed a wide range of subjects in which State legislation touches incidentally upon bankruptcy, or in which bankruptcy proceedings affect rights acquired under a State Act. In many such cases the Commonwealth Act does not make any provision. The most common example of such incidental matters occurs when a State Act provides for a specified result to occur upon the bankruptcy of a party to a transaction. In such a case, the State law is valid unless the Bankruptcy Act expressly or by necessary implication overrides the State provision.[4]

1.4.05 The American Constitution grants to Congress the legislative authority to pass "uniform laws on the subject of bankruptcies throughout the United States." Thus it is apparent from the very wording of the Constitution that Congress could not, in its legislation, adopt different terms and conditions for the various States, for, in order to be constitutional, every provision must apply to all the States. Moreover, the legislative power of Congress not being exclusive, the States can legislate in the absence of federal legislation. As Congress has passed a Bankruptcy Act and this Act is still in force, it may be asked whether there is still room for the States to also enact bankruptcy legislation. This question is discussed as follows by a writer:

> The enactment of a national bankrupt law does not operate to annul State laws on the same subject, but simply to suspend their operation so long as the national regulations are in force. Upon the repeal of the Federal law the State laws at once revive, and do not need reenactment. So also a State law passed while a Federal bankruptcy law is in force goes at once into force with the repeal of the Federal statute.

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[3] B.H. McPHERSON, *The Law of Company Liquidation*, Sydney, The Law Book Company Limited, 1968, pp. 24 and 25.

[4] Dennis J. ROSE, *Laws' Australian Bankruptcy Law*, 5th ed., Sydney, The Law Book Co. Ltd., 1967, p. 5.

> The precise effect of the enactment of a Federal bankruptcy law in suspending the operation of existing State laws is not definitely determinable from the decisions of either the State or Federal courts. That a State law covering the same ground as the national act, even though its provisions be not inconsistent therewith, is suspended is generally, though not uniformly, admitted. If, then, it be conceded that the intention of Congress was, by the enactment of a bankrupt law, to cover the entire subject, all State laws relating to bankruptcy are suspended while the national law remains in force.
>
> Even if the view be accepted that by the act of 1898 the general subject of bankruptcy is fully covered there still remains, in many cases, the difficulty of determining when State laws relating to general assignments for the benefit of creditors, receivership of corporations, etc., may be held to be in the nature of bankruptcy laws and as such rendered inoperative during the existence of the Federal law.[5]

1.4.06 The word "bankruptcies" used in the American constitution has been given a very broad meaning by the courts. According to the Supreme Court,

> The subject of bankruptcies is incapable of final definition. The concept changes. It has been recognized that it is not limited to the connotation of the phrase in England or the United States at the time of the formulation of the constitution. An adjudication in bankruptcy is not essential to the jurisdiction.
>
> The subject of bankruptcies is nothing less than the subject of the relation between an insolvent or non-paying debtor and his creditors extending to his and their relief.[6]

As a result of this position taken by the American courts,

> The subject of bankruptcies embraces the entire field of debtor-creditor relationships for the purpose of the equitable distribution of a debtor's estate, rehabilitation of the debtor, and the protection of the credit structure against anything materially contributing toward its impairment.[7]

1.4.07 *Basis for Federal Legislative Authority*: In Canada, as in Switzerland, Australia and the United States, the federal Parliament has legislative authority over insolvency and bankruptcy. What is the justification for giving this power to the federal authorities? As regards the Canadian Constitution, Judge Wurtele, of the Superior Court of the Province of Quebec, supplied the following explanation in his reasons for a judgment delivered in 1888:

> The Dominion is formed of different provinces, and there is, of course, more or less diversity in their laws regulating the collection of debts and the settlement of the estates of insolvents; and the power of the provincial courts to execute provincial laws does not extend beyond the territory of the province to which they belong. It is therefore in the interest of the trade and commerce of the whole Dominion that there should be one uniform law for all the provinces, regulating proceedings in the case of insolvent debtors, unrestricted in its operation by provincial boundaries, that it should be possible to obtain a national execution, and not merely a limited provincial one, against the estate of an insolvent debtor, who might hold property in several provinces, or transfer it from his own province into another.[8]

1.4.08 In its introductory words, section 91 of the *British North America Act, 1867*, gives to the Parliament of Canada the authority "to make Laws for the Peace, Order and good Government of Canada, in relation to all Matters not coming with the Classes of Subjects by this Act assigned exclusively to the Legislatures of the Provinces". "For greater Certainty", it enumerates certain classes of subjects, after

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[5] W.W. WILLOUGHBY, *The Constitutional Law of the United States*, 2nd ed., vol. II, New York, Baker, Voorhis & Co., 1929, S. 644, pp. 1099 and 1100.

[6] *Wright* v *Union Central Insurance Co.* (1938), 304 U.S. 502 at 513.

[7] *Collier on Bankruptcy*, edited by J.W. MOORE, 14th ed., New York, Matthew Bender, 1969, vol. 1, p. 6.

[8] *Dupont et vir* v *La Cie de Moulin à Bardeau Chanfréné*, (1888) II *The Legal News*, p. 225 at p. 227.

having granted to the Parliament of Canada the exclusive legislative authority over all matters coming within them. As "Bankruptcy and Insolvency" are enumerated under head 21, all matters coming within these classes of subjects would be beyond the legislative competence of the provincial legislatures, even if the Parliament of Canada had enacted no legislation in relation thereto.[9]

1.4.09 Section 91 also contains in its enumeration certain classes of subjects connected with bankruptcy, namely, the regulation of trade and commerce under head 2, interest under head 19 and the criminal law under head 27. As the exclusive legislative authority of the Parliament of Canada extends to all matters coming within these classes of subjects, it is, from a constitutional point of view, purely academic to consider, for instance, whether a legislative provision is, in pith and substance, bankruptcy legislation or criminal law legislation.

1.4.10 In the legal terminology, the federal legislation is bisected into that which is *per se* federal and that which is merely ancillary to a class of subject under the exclusive legislative authority of the Parliament of Canada. According to Mr. Justice Laskin, this is a distinction without a difference:

> (The) use (of the "trenching" doctrine) to explain a privileged encroachment on provincial legislative authority is purely gratuitous because once a court is satisfied that impugned legislation carried a federal "aspect", no invasion of provincial legislative authority exists... To say that the Dominion in legislating in relation to a matter coming within an enumerated class of subject in section 91 can also enact provisions which are necessarily incidental to effective legislation under the enumerated class is a tortuous method of explaining the "aspect" doctrine... Legislation, as the Judicial Committee has itself said from time to time, must be considered as a whole and its aspect ascertained in the light of all its provisions. To make what can only be an artificial distinction between those provisions of a federal enactment which are strictly in a federal aspect and those necessarily incidental to the effective operation of the legislation, is to trifle with legislative objectives and with the draftsman's efforts to realize them.[10]

1.4.11 In 1894, at a time when no federal legislation on bankruptcy and insolvency was in force in Canada, an *obiter dictum* from Lord Herschell, of the Judicial Committee of the Privy Council, explained the "ancillary" doctrine in its application to bankruptcy and insolvency as follows:

> (Their Lordships) would observe that a system of bankruptcy legislation may frequently require various ancillary provisions for the purpose of preventing the scheme of the Act from being defeated. It may be necessary for this purpose to deal with the effect of executions and other matters which would otherwise be within the legislative competence of the provincial legislature. Their Lordships do not doubt that it would be open to the Dominion Parliament to deal with such matters as part of a bankruptcy law, and the provincial legislature would doubtless be then preduced from interfering with this legislation inasmuch as such interference would affect the bankruptcy law of the Dominion Parliament[11].

This *obiter dictum* was in line with a previous pronouncement of the Judicial Committee in a case where it had to decide whether, in enacting *The Insolvency Act* in 1875, the Parliament of Canada could limit appeals:

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[9] *Union Colliery Co.* v *Bryden, (1899) A.C. 580 at 588; A.-G. Can* v *A.-G. Ont.* (1898) A.C. 700 (Fisheries Case); *A.G. for Can.* v *Attorney-General for Ont., Que. and N.S.*, (1898) A.C. 700 at 715; *Reference re Debt Adjustment Act*, 1937, 1943 A.C. 356; *Reference re The Orderly Payment of Debts Act*, 1959 (Alberta), (1960) 1 C.B.R. (n.s.) at p. 207 and p. 222.

[10] Bora LASKIN, *Peace, Order and Good Government Re-examined* (1947) 25 Can. Bar Rev. 1054, at pp. 1060 and 1061.

[11] *A.-G. Ont.* v *A.-G. Can.* (1894) A.C. 189, p. 200.

> It would be impossible to advance a step in the constitution of a scheme for the administration of insolvent estates without interfering with and modifying the ordinary rights of property, and other civil rights, nor without providing some mode of special procedure for the vesting, realization and distribution of the estate, and the settlement of liabilities of the insolvent. Procedure must necessarily form an essential part of any law dealing with insolvency. It is therefore, to be presumed, indeed it is a necessary implication, that the Imperial Statute, in assigning to the Dominion Parliament the subjects of bankruptcy and insolvency, intended to confer on it legislative power to interfere with property, civil rights and procedure within the provinces, so far as a general law relating to these subjects might affect them. Their Lordships, therefore, think that the Parliament of Canada would not infringe the exclusive powers given to the provincial legislature by enacting that the judgment of the Court of Queen's Bench in matters of insolvency should be final. . .[12]

1.4.12 *Provincial Legislation on Bankruptcy and Insolvency:* The provincial legislatures do not possess legislative authority over bankruptcy and insolvency and could not pass valid laws in this field, even in the absence of federal legislation. This result follows logically from the fact that sections 91 and 92 grant to the Parliament of Canada and to the provincial legislatures exclusive legislative power in their respective fields. As it was stated by the Judicial Committee of the Privy Council,

> the abstinence of the Dominion Parliament from legislating to the full limit of its powers could not have the effect of transferring to any provincial legislature the legislative power which had been assigned to the Dominion by s. 91 . . .[13]

1.4.13 It should not be inferred from the foregoing that the Provincial legislatures cannot pass legislation having effect in the field of bankruptcy and insolvency. However, such legislation is only *intra vires* insofar as it deals with matters outside this field and included in the classes of subjects enumerated in section 92. Thus, in 1894, a decision of the Judicial Committee of the Privy Council recognized the legislative authority of Ontario to pass legislation regarding assignements of property. In explaining the decision, Lord Herschell emphasized the fact that the assignment of property was not subject to the insolvency of the debtor:

> Moreover, the operation of an assignment for the benefit of creditors was precisely the same, whether the assignor was or was not in fact insolvent. It was open to any debtor who might deem his solvency doubtful, and who desired in that case that his creditors should be equitably dealt with, to make an assignment for their benefit. The validity of the assignment and its effect would in no way depend on the insolvency of the assignor, and their Lordships think it clear that the 9th section would equally apply whether the assignor was or was not insolvent. . .[14]

1.4.14 As, in legislating on a matter within its legislative authority, a Provincial legislature can affect matters relating to bankruptcy and insolvency, that is to say, modify the rights and obligations of an insolvent person and of his creditors, the possibility of a conflict between a provincial act and federal legislation exists. In such a case, the latter would prevail.

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[12] *Cushing* v *Dupuy,* (1880) 5 A.C. 409, p. 415.

[13] *Union Colliery Co.* v *Bryden,* (1899) A.C. 580, at p. 588; see also *A.G. Can.* v *A.G. Ont.* (1898) A.C. 700.

[14] *A.-G. Ont.* v *A.G. Can.,* (1894) A.C. 189, at p. 199. This decision was commented as follows by Kerwin C.J.C. (Taschereau, Fauteux, Abbot, Judson and Ritchie concurring) in the *Reference re The Orderly Payment of Debts Act, 1959 (Alberta)* (1960) 1 C.B.R. (n.s.) 212: ". . . it is doubtful whether, in view of later pronouncements of the Judicial Committee it would at this date be decided in the same sense, even in the absence of Dominion legislation upon the subject of bankruptcy and insolvency."

1.4.15 On a reference to the Supreme Court of Canada, Mr. Justice Cartwright summed up as follows the conditions under which a provincial act can, without being *ultra vires,* modify the rights and obligations of an insolvent person and of his creditors:

> In every decision of the Judicial Committee or of this Court in which provincial legislation, impugned on the ground that it affected the rights and obligations of an insolvent entity and its creditors and thereby trenched on the subject matter comprised in head 21 of s. 91, has been upheld it appears that in the view of the Court, two conditions were found to exist;
>
> (i) that the impugned legislation was not in pith and substance primarily in relation to bankruptcy and insolvency but rather in relation to one or more of the matters enumerated in s. 92; and
>
> (ii) that insofar as it affected the rights and obligations of an insolvent and its creditors, it did not conflict with existing valid legislation of Parliament enacted in exercise of the power contained in head 21 of s. 91.[15]

1.4.16 *Provincial Legislation Concerning Transactions of Debtors in Fraud of Creditors:* There is both federal and provincial legislation designed to protect creditors from the fraudulent transactions of their debtors.

1.4.17 In Quebec, the legislation is contained in articles 1032 *et seq.* of the *Civil Code,* which authorize creditors to bring an "action paulienne". One of the most common examples where such an action may be brought is where an insolvent debtor makes a preferential payment to a creditor who has knowledge of the insolvency of the debtor. As the articles of the *Civil Code* giving rise to "L'action paulienne" were enacted in 1866, there can be no doubt as to their initial constitutional validity on the advent of Confederation in the following year. Section 129 of the *British North America Act* provides that all existing legislation would continue in force after Confederation "subject nevertheless . . . to be repealed, abolished or altered by the Parliament of Canada, or by the legislature of the respective Province, according to the authority of the Parliament or that Legislature under this Act."

1.4.18 Whether it is the Parliament of Canada or the Legislature of the Province of Quebec that has the authority to alter the provisions of the *Civil Code* relating to "l'action paulienne" depends upon the view one takes as to the nature of this legislation. If it is considered to be in pith and substance a matter of insolvency, it comes within the legislative authority of the federal Parliament. If, on the other hand, it is considered to be a matter primarily relating to "Property and Civil Rights", it comes under the legislative authority of the Province of Quebec. However, in either hypothesis, it is important to determine whether or not the legislation is in conflict with valid federal legislation, such as the *Bankruptcy Act,* for in the case of the first hypothesis there would be an implicit abrogation, and, in the context of the second, the legislation would be considered to be inoperative due to the paramountcy of the federal legislation. On this last point, the observation should be made that the Quebec Courts have invariably interpreted "l'action paulienne" as not repugnant, but as supplemental, to the law of bankruptcy.

[15] *Reference re: The Orderly Payment of Debts Act, 1959, (Alberta)*, (1960-61) 1 C.B.R. (n.s.) 207 at pp. 226 and 227.

1.4.19 In the common law provinces, the situation is different. Instead of a pre-confederation statute followed by the federal *Bankruptcy Act,* as in the case of Quebec, there was provincial legislation[16] after Confederation in the form of Fraudulent Conveyances Acts and Fraudulent Preferences Acts. The latter, as their names indicate, are concerned with preferential payments. They permit certain preferences to be set aside, independently of bankruptcy, as is also permitted by article 1036 of the Quebec *Civil Code.* The necessity for this provincial legislation in the Common Law provinces is due to the fact that there was no federal bankruptcy legislation from 1880 to 1919.

1.4.20 The courts have considered the constitutionality of *The Fraudulent Preferences Act* of Alberta, *The Fraudulent Preferences Act* of British Columbia and the *Assignments and Preferences Act* of Ontario. The Supreme Court of Alberta found the Alberta statute unconstitutional. According to Mr. Justice Milvain:

> Its pith and substance is directly and only that of dealing with matters hinged on insolvency.[17]

This judgment was upheld by the Court of Appeal, but it was only prepared to hold that the Act was either *ultra vires* or inoperative.

1.4.21 Both *The Fraudulent Preferences Act* of British Columbia [18] and *The Assignments and Preferences Act* of Ontario were held to be inoperative. The majority of the Ontario Court of Appeal, in *In re Trenwith* adopted the view expressed by Mr. Justice Masten at the trial:

> It seems to me that the common field of the legislation respecting the distribution of the estates of insolvents having now become occupied by the Dominion Bankruptcy Act, the provisions of the Assignments and Preferences Act respecting the preference of one creditor over another have been thereby superseded and have ceased to have any operation.[19]

In the *Bozanich Case* Chief Justice Duff expressed the same opinion:

> I may add that, in my opinion, the provisions R.S.O. 1926 c. 26 in relation to preference are superseded by section 64, and that the authority of the Ontario Legislature to enact such legislation is, in consequence of the enactment of section 64, suspended in virtue of the concluding paragraph of section 91.[20]

1.4.22 Notwithstanding these judgments, the situation, from a constitutional point of view, of these provincial statutes is still confusing. While there is substantially similar legislation in respect to preferences in all provinces, creditors in at least three provinces, in order to protect themselves against preferential payments made by their insolvent debtors, must resort to bankruptcy proceedings, while, in the other provinces, there is at least uncertainty as to whether or not the

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[16] See for British Columbia: *The Fraudulent Conveyances Act* (1960) R.S.B.C. C. 155 and *The Fraudulent Preferences Act* (1960) R.S.B.C. C. 156; for Alberta: *The Fraudulent Preferences Act* (1955) R.S.A. C. 120; for Saskatchewan: *The Fraudulent Preferences Act* (1965) R.S.S. C. 397; for Manitoba: *The Fraudulent Conveyances Act* (1954) R.S.M. C. 91 and *The Assignments Act* (1954) R.S.M. c. 11; for Ontario: *The Assignments and Preferences Act* (1914) R.S.O. C. 194 and (1960) R.S.O. C. 25 and *The Fraudulent Conveyances Act* (1960) R.S.O. C. 154; for New Brunswick: *The Assignments and Preferences Act* (1952) R.S.N.B. C. 13, and, finally, for Nova Scotia: *The Assignments and Preferences Act* (1967), R.S.N.S., C. 16.

[17] Re *McIntosh – Marshall Equipment Ltd.: Nash* v *Guelph Engineering Co.* (1964) 48 W.W.R. 420; (1965) 7 C.B.R. (n.s.) 84 at p. 88.

[18] *Hoffar Ltd.* v *Canadian Credit Men's Trust Association Ltd.* (1929) S.C.R. 180.

[19] *Re Trenwith* (1933-34) 15 C.B.R. 372, at p. 376.

[20] *In re Bozanich* (1942) S.C.R. 130, at p. 136.

particular provincial Preference Statute is constitutional. Moreover, as the *Fraudulent Preferences Acts* of three provinces have been found to be unconstitutional or inoperative, there is some doubt as to whether certain provisions of the Fraudulent Conveyances Acts may not also be unconstitutional.

1.4.23 *The Extent of Federal Jurisdiction under Section 91 (21):* If the exclusive competence of the Parliament of Canada over each of the classes of subjects enumerated in section 91 is well established, one could still question how broad an interpretation should be given to bankruptcy and insolvency. Although there have been a relatively large number of cases on the question, the Courts have not given any precise definition of these two concepts. This is not in itself surprising, for the courts on constitutional matters tend to avoid abstract or general statements and doctrinal discussions. However, in order to describe the extent of the constitutional grant of power over bankruptcy and insolvency with any precision, it is necessary to summarize the decisions of the courts on this question.

1.4.24 In a decision rendered in 1888[21], the Superior Court of Quebec refused to give a narrow interpretation to the words "bankruptcy and insolvency". In that case, it had been contended that the legislative power of the Parliament of Canada does not extend to laws providing for a distribution of an insolvent debtor's estate without a concurrent discharge from his liabilities and that the *Winding Up Act* was therefore unconstitutional. The Court held that the ultimate purposes of bankruptcy and insolvency are distribution and discharge and that Parliament had full discretion to legislate to the extent of its power or within its power. In other words, whether the legislation shall release the debtor from further liability or not is a mere matter of policy. To appreciate the correctness of these views, it should be borne in mind that, under the bankruptcy system of some countries, for instance France, the debtor is not entitled to a discharge, except with the unanimous consent of the creditors.

1.4.25 In *Attorney-General for British Columbia* v *Attorney-General for Canada* (*In Re Farmers' Creditors Arrangement Act*) the Province of British Columbia alleged that the Act does not truly form legislation relating to "bankruptcy and insolvency" but is an invasion of the sphere of the provincial legislatures in relation to "Property and Civil Rights in the Province". In its report, the Judicial Committee of the Privy Council said:

> In a normal community it is certain that these conditions (which bring the bankruptcy law into operation) will require revision from time to time. Their Lordships are unable to hold that the statutory conditions of insolvency which enabled a creditor or the debtor to invoke the aid of the bankruptcy laws, or the classes to which these laws applied, were intended to be stereotyped under head 21 of section 91 of the *British North America Act* so as to confine the jurisdiction of the Parliament of Canada to the legislative provisions then existing as regards to these matters.[22]

1.4.26 It results, from the position taken by the Privy Council in respect of the constitutionality of the *Farmers' Creditors Arrangement Act,* that as in the United States (*supra* 1.4.06), the concepts of bankruptcy and insolvency are not

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[21] *Supra*, note 8.
[22] (1937) 18 C.B.R., 217 at p. 222 (P.C.).

limited to the connotation they had at the time of the Constitution. As society changes, so does the subject matter in relation to which the Parliament of Canada has exclusive legislative authority under head 21 of section 91 of *The British North America Act, 1867.* Insofar as it does not resort to colourable devices, the discretion committed to the Parliament of Canada is unfettered. It is so wide that, in our opinion, Parliament may validly adopt legislation in prevention of insolvency and bankruptcy such as that proposed *infra* in 3.1.41. As Viscount Simon L.C. once stated:

> . . . to legislate for prevention appears to be on the same base as legislation for cure.[23]

1.4.27 *Courts and Procedure:* The Parliament of Canada is authorized to create courts, not by section 91, but by section 101 of the *British North America Act, 1867.* This section reads as follows:

> 101. The Parliament of Canada may, notwithstanding anything in this Act, from time to time, provide for the Constitution, Maintenance, and Organization of a General Court of Appeal for Canada, and for the Establishment of any additional Courts for the better Administration of the Laws of Canada.

Under this section, the Parliament of Canada, in addition to establishing a General Court of Appeal for Canada, has the authority to create any additional court to ensure the better administration of the laws of Canada. This does not, however, permit Parliament to create a court charged with the settlement of 'disputes' in matters coming under the classes of subjects over which the provincial legislatures have exclusive legislative power. Indeed, it is well established that the words "laws of Canada" refer solely to the law relating to matters coming under federal legislative authority.[24] As the subjects of "bankruptcy and insolvency" come within this authority, there can be no doubt that Parliament can give jurisdiction over this field of law either to an existing federal court, such as the Exchequer Court of Canada, or to any new federal Court it may create to specifically assume this jurisdiction.

1.4.28 In either case, there is the very real question as to whether or not a federal court, in the exercise of its jurisdiction, can incidentally apply provincial law. According to Mr. Justice Laskin in his book, *The Canadian Constitutional Law:*

> The recognition in the Exchequer Court of provincial legislation defining substantial law–depends . . . on the substantive law declared by Parliament under s. 101 of the B.N.A. Act to be applicable therein or, failing such statutory declaration, on the common law (or admiralty law as well) applicable to the assigned jurisdiction. Provincial statute law cannot apply unless there is some federal statutory basis for finding that it was incorporated into federal law for federal purposes.[25]

1.4.29 It should be noted that section 101 of the B.N.A. Act is not peremptory. It merely empowers Parliament to establish "from time to time . . . any additional courts . . ." There is, moreover, no practical necessity to

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[23] *A.G. Ont. v Can. Temperance Federation.*, (1946) 2 D.L.R. (A.C.) 193; 85 Can. CC. 225.

[24] Bora LASKIN, *Canadian Constitutional Law,* 3rd ed., Toronto The Carswell Company Ltd., 1966, p. 187; Gilles PEPIN, *Les Tribunaux administratifs et la constitution,* Montréal, Les Presses de L'Université de Montréal, 1969, pp. 325 and 326.

[25] Bora LASKIN, *op. cit.*, note 24, p. 822.

establish new courts, for Parliament can rely on the provincial courts to adjudicate upon all matters arising out of any federal statute. Indeed, it can, in matters coming under its legislative jurisdiction, impose judicial duties not only on provincial courts, but also on any provincial civil servant, any individual or any institution. This was established by the Supreme Court of Canada in *Valin* v. *Langlois*[26] and has been confirmed on several significant occasions, notably in 1903, in *In re Vancini*[27], in which Mr. Justice Sedgewick adopted the following statement made by A.H.F. Lefroy:

> The Dominion Parliament can, in matters within its sphere, impose duties upon any subjects of the Dominion, whether they be officials of provincial courts, other officials, or private citizens, and there is nothing in the *British North America Act* to raise a doubt about the power of the Dominion Parliament to impose duties upon existing Provincial Courts or to give them new powers as to matters which do not come within the subjects assigned exclusively to the legislatures of the provinces or to deprive them of jurisdiction over such matters.[28]

1.4.30 When the Parliament of Canada wishes the provincial courts to have jurisdiction over issues arising out of federal legislation, it is not necessary that such jurisdiction be specifically conferred upon the provincial courts. *The Bills of Exchange Act* is, for example, silent as to the court which has the jurisdiction to try issues arising out of it. Yet, litigants obtain, from the provincial courts, legal recognition of the rights conferred on them by this Act[29]. This is explained by Mr. Justice Laskin as follows:

> The abstention of Parliament from setting up federal courts of first instance to try issues falling within federal competence does not leave them at large. It is fully accepted that they may be triable in the provincial courts, either as a matter of entertaining common or decisional law causes of action (whether provincial or federal common or decisional law) or as a matter of exercising jurisdiction arising under federal legislation, whether the legislation explicitely confers it or not. As the Privy Council put it in *Board* v. *Board,* (1919) A.C. 956, 48 D.L.R. 13, (1919) 2 W.W.R. 940: "If the right exists, the presumption is that there is a Court which can enforce it, for no other mode of enforcing it is prescribed, that alone is sufficient to give jurisdiction to the King's Courts of Justice. In order to oust jurisdiction it is necessary in the absence of a special law excluding it altogether to plead that jurisdiction exists in some other Court". The application of this proposition to provincial courts depends, it is submitted, on whether the provincial Courts have the jurisdiction to adjudicate on the right which is in question. Such jurisdiction has, by and large, been found in pre-confederation powers of such Courts which have a continuing force under s. 129 of the B.N.A. Act. Where, after Confederation, it is evident that a provincial Court has no jurisdiction in respect of matters falling within exclusive federal competence, the central question is whether Parliament alone may confer it. Clearly the substantive justiciable matter must be found only on a statute of Parliament or on existing common law which would be subject to Parliament's control. Where a federal statute embraces or declares the right sued upon, it may quite conceivably be held as a matter of construction, or of implicit reference, that provincial courts are envisaged as the agencies of enforcement.[30]

1.4.31 It follows from the foregoing that, in matters coming under its jurisdiction, the Parliament of Canada can either establish a system of courts parallel to the provincial courts or accept the principle of the "communality" of the

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[26] (1879) 3 S.C.R. 1, p. 37-38; (1879) 5 A.C. 115.
[27] (1903-1904) 34 S.C.R. 621, pp. 625 and 626.
[28] A. LEFROY, *The Legislative Powers in Canada,* Toronto, The Toronto Law Book and Publishing Co. Ltd., 1897-98, p. 510.
[29] Gilles PEPIN, *op. cit.,* p. 343.
[30] Bora LASKIN, *op. cit.,* note 24, p. 818.

provincial courts. In respect to the second hypothesis, Parliament has the power to establish the procedure that the provincial courts must follow in the exercise of their federal functions. This principle was, as we have seen, established beyond a doubt by *Cushing* v. *Dupuy* in 1880.[31]

1.4.32 *Conclusion:* As shown in this chapter, the Parliament of Canada has exclusive legislative power over bankruptcy and insolvency and these two subject matters have been broadly interpreted by the courts. Moreover, whenever it is necessary for the effective operation of its legislation in this field, Parliament may deal with matters that would otherwise be within the exclusive legislative competence of the provincial legislatures. By way of conclusion, to the extent that there are legal remedies to the problems related to bankruptcy and insolvency, it is the responsibility of Parliament to look for these remedies and to legislate accordingly, as its legislative authority is supreme for this purpose.

[31] See *supra* 1.4.11.

CONCLUSION

1.5.01 It follows from what precedes that the fate of the insolvent debtor has been subject to incessant changes. In ancient times, he was exposed to infamy, slavery, and even death; to avoid such barbarous treatment, he could resort to extreme measures such as selling members of his family. As social attitudes became more mild, such extreme measures were prohibited, but a debtor was given the possibility to escape punishment by surrendering his property to his creditors. Even from this angle, the assignment of the debtor's property had the effect of a valve. The debtor was no longer forced to commit barbarous acts or resort to crime in order to preserve his honour, freedom or life.

1.5.02 In 1.3. above, we described the last stage of this long evolution, as far as Canada is concerned. However, it would be naive to pretend that this is the ultimate point in the evolution. For this reason, it is necessary to scrutinize the economic and social realities of today in order to ascertain whether the present bankruptcy and insolvency legislation is adapted to our needs and determine how it should be oriented for the future.

Part II

The Need for Change

INTRODUCTION

2.0.01 No law operates in a vacuum. Its adequacy can only be measured by reference to the needs of the society that it serves. The law of bankruptcy is no exception to this. Chapter I briefly outlines some of the more important changes that occurred in our society in recent years insofar as they may be considered to have an impact in the field of bankruptcy and insolvency.

2.0.02 One of the most important features of any bankruptcy system is the machinery set up to administer it. Chapter 2 examines some of the major weaknesses of the present system as they pertain to the various mechanisms relating to the administration of estates in bankruptcy and to the various devices that have been provided to control it.

2.0.03 Some of the difficulties of the present bankruptcy system have their origin in the faulty drafting and technical deficiencies that abound in the Act. In the final chapter, some of the more important of these difficulties are examined.

CHAPTER I

BANKRUPTCY IN A CHANGING SOCIETY

2.1.01 *Bankruptcy and the Legal Order:* No law can be examined in isolation from the society it serves. Law has been described as a scheme of social ends that involves the continuous balancing of conflicting interests. Although "the end of law is peace, the life of law is a struggle—a struggle of nations, of the state power, of classes of individuals."[1] Roscoe Pound described "the legal order as a regime of adjusting relations and ordering conduct through the systematic and orderly application of the force of a politically organized society, in order to prevent friction in the human use and the enjoyment of the goods of existence and eliminate waste of them."[2]

2.1.02 Bankruptcy legislation is an attempt, on the one hand, to identify and relieve the insolvent debtor who cannot meet his obligations, and, on the other hand, to ensure that his creditors will be treated fairly and equitably. In accomplishing this, it is essential that we endeavour to balance our social needs and beliefs with the requirements of our credit oriented economy.

2.1.03 Although there has been a steady evolution in the Canadian bankruptcy legislation, the fact that it has remained substantially the same for so long without any major revision seems to indicate that it has, for some time, achieved reasonable success in identifying and relieving the honest but unfortunate debtor without sacrificing the needs of creditors for fair and equitable treatment. The general satisfaction that may have, however, existed previously with the legislation no longer prevails.

2.1.04 We live in an affluent society. It is characterized by mass production, mass consumption, built-in obsolescence, television, the electric appliance industry, the industries catering to the boating, camera and sporting enthusiast, the two and three car family, the new ease and convenience of travel and the urbanization of the

[1] RUDOLPH VON IHERING, *Der Kamps Ums Recht* (The Struggle for Law) 1872, quoted in W. SEAGLE, *Men of Law,* New York. The MacMillan Co., 1947, p. 38.
[2] R. POUND, *Introduction to American Law* in VANDERBILT, *Studying Law,* p. 379.

population. Accompanying this new affluence have been changing concepts of the morality of work and debt, new methods of doing business and financing, increased taxation, tax avoidance schemes, the proliferation of limited liability corporations, the advent of the credit card economy, with the "I can get it wholesale", "buy now, pay later" and expense account living, inroads by organized crime and the increasing incidence of white collar crime. The question must be asked whether any *Bankruptcy Act* framed before all this came into existence or attained widespread proportions is well adapted to the needs of our present society. It would be surprising if the underlying premises of our present Act were still relevant. New principles, however, cannot be formulated and no attempt can be made to arrive at a new balance between competing interests until the existing areas of friction are identified and fundamental problems are discussed.

2.1.05 *Methods of Production and Marketing:* Modern methods of production and marketing have contributed to a very great extent to making the bankruptcy and insolvency legislation out-of-date. From the Roman times until the last century, a plough, for example, had an economic value that scarcely depreciated when it changed hands. Goods were then in short supply and consumers did not place the same premium, as they do today, on a new article as compared to a used one. For this reason, from the time of the *cessio bonorum,* the assets of a debtor did not substantially depreciate when they passed from the hands of a debtor to those of his creditors. This factor contributed to make it profitable for the creditors to put into operation the bankruptcy process. As goods retained their value, the proceeds from the realization of the bankrupt estate were more likely to exceed the cost of administration.

2.1.06 Today, the overwhelming goal of the modern industrial system is to achieve the greatest possible rate of corporate growth as measured in sales. J.K. Galbraith, in *The New Industrial State,* writes: "The individual serves the industrial system not by supplying it with savings and the resulting capital. He serves it by consuming its products . . . a family's standard of living becomes an index of its achievement. It helps insure that the production and *pari passu* the consumption of goods will be the prime measure of social accomplishment."[3] Under these circumstances, used goods in the hands of a trustee in bankruptcy have only a fraction of the value they had while in the hands of the debtor. This is particularly true in the case of consumer bankruptcies. But even in a business bankruptcy, inventories of completely manufactured goods are very often sold by trustees much below their cost. This is, frequently, by reason of the fact that customary manufacturers' warranties cannot be given or honoured. Even where goods have been converted into accounts receivable, the amount a trustee is expected to recover is usually much less than their value, although the debtor, if he had not become bankrupt, would normally have counted upon collecting the full amount with only a small allowance for bad debts. Seasonable goods lose much of their value if sold in the off-season. Inventory, in the course of manufacture, often has no more than scrap value. Many assets depreciate very quickly. Newly produced motor vehicles may

[3] J.K. GALBRAITH, *The New Industrial State,* Boston, Houghton Mifflin Co., 1967, p. 49.

depreciate as much as forty per cent for the first year. Basically, the problem is that a trustee must liquidate the goods of a debtor outside of the normal marketing channels. This contributes to the diminishing dividends paid to unsecured creditors.

2.1.07 *The Credit System:* Another important factor that has put the bankruptcy system out of balance is the explosive use of credit, particularly consumer credit, since the second world war. New and burgeoning consumer oriented industries have expanded through complex methods of mass production. This has been made possible only because of the emergence of mass markets which, in the case of durable consumer goods, such as expensive appliances and motor cars, require readily available financing provided for by the instalment payment plan.

2.1.08 One would expect that most credit transactions are entered into by credit grantors only after a careful consideration of the capacity of the borrower or purchaser to fulfill his obligation. This is often not the case. Some producers may choose to operate closer to full capacity in order to lower their costs and, to dispose of the production, may deliberately extend credit to the marginal or sub-marginal risks. The same may be true of wholesalers, retailers and finance institutions who may attempt to increase their volume of business in relation to their overhead. Finally, it is relevant to recall that bad debts are anticipated by those in business. A reserve or allowance is made for bad debts as a cost of doing business. This reduces the income tax payable by the credit grantor and has the effect of distributing his losses over all of the tax-paying public.

2.1.09 The principles underlying the *Bankruptcy Act* developed when there was much less credit and when the credit that was granted was only extended after careful consideration. Today, "the endless stream of persuasion via television, radio, magazines, newspapers, billboards and in the mail has become a predominant part of our environment."[4] The businessman and the consumer are exhorted to buy now and pay later; in short, to become indebted.

2.1.10 As far as consumers are concerned, one of the main reasons for their discontent is often the ambivalent attitude on the part of their creditors. Too often, a debtor is persuaded to buy something against his own interest by a high pressure salesman. If the debtor later finds that he is unable to pay and withholds payment, his wages are garnished. If this triggers a bankruptcy, he is told that he is responsible for his misfortune.

2.1.11 Not only creditors, but also debtors, may abuse the credit system. Opportunity for gain at the expense of others has always presented great temptations. During the centuries preceding the development of our credit economy, the sanctions against insolvent debtors have been progressively alleviated. As the law is now more humane and lenient, some debtors, with loose moral standards or not personally affected by the stigma that, in the minds of some, attaches to bankruptcy, may abuse the credit facilities.

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[4]CANADA, *Report on Consumer Credit* of the Special Joint Committee of the Senate and the House of Commons on Consumer Credit and Cost of Living, Ottawa, Queen's Printer, 1967, p. 92.

2.1.12 The legislation should curb the abuses of credit by both creditors and debtors. The legal consequences of granting or receiving credit must be readjusted to meet changed conditions. As there are good and bad debtors, so are there good and bad creditors. As all debtors are not treated the same, neither should all creditors. The traditional concept that "equality is equity" and its corollary that creditors, as a rule, should be paid *pari passu* needs re-examination.

2.1.13 *Consumer Bankruptcies:* The plight of the consumer or wage-earner debtor is one of the most important problems that must be faced in the field of bankruptcy in Canada. To a certain extent, this group of debtors represent the social and economic casualties of our industrial and credit system and must be so regarded.

2.1.14 It must not be forgotten that in our society the producer and marketing organizations make vast investments in sales promotion and advertising aimed at creating a demand to buy more. To facilitate this, the greater use of consumer credit is encouraged. It has become the normal pattern of urban life in Canada. Too often those who should most strongly resist this pressure are those who are the least educationally, intellectually and culturally prepared to withstand the pressure.

2.1.15 The size of the problem may also be seen in a statistic provided by the Division Court Referee, County of York, in Toronto. This position was created to assist the County Court Judge in Chambers to make orders for payment of debts that are fair to all parties concerned. In 1968, the Referee in Toronto interviewed a total of approximately 7,500 persons who declared debts amounting to over $20,000,000.[5]

2.1.16 Many of those who resort to consumer credit find that they are in a trap from which they cannot escape. Through bad fortune, with one financial emergency following another and often from mismanagement, this group of debtors become deeper and more hopelessly in debt. Interest piles up on interest, and as payments are not sufficient to cover the interest, the principal of the debt is very often increased instead of being reduced.

2.1.17 There is much personal tragedy for those who become hopelessly in debt. Each case involves a person who has failed, a person who has been defeated. The failure and defeat not only affect the debtor, but his wife, family, friends and acquaintances. Many children, to escape a harsh, bleak and degrading environment, marry young and become themselves members of the chronic poor.

2.1.18 The facilities that society provides to relieve the consumer debtor, too often, are not effective or are illusory. In a great majority of cases, bankruptcy is financially beyond the reach of those who most need it. Similarly, there is no adequate, simple and inexpensive procedure permitting a small debtor to make an arrangement with all of his creditors either inside or outside the *Bankruptcy Act.* Moreover, the remedies available to creditors often result in debtors being disproportionately punished for their defaults.

[5] Taken from the records of the Division Court Referee for the County of York.

2.1.19 It is frequently said that the *Bankruptcy Act* functions so as to rehabilitate the small debtor. The general uncertainty and confusion over what is meant by rehabilitation is well described by the Honourable Joe Lee, Referee in Bankruptcy for the Eastern District of Kentucky, who wrote recently:–

> A review of the literature reveals that there is disagreement as to what is actually meant by rehabilitation. There is no generally accepted definition, certainly none that spells out goals in such a way as to identify the nature and degree of change expected. Does the *Bankruptcy Act* assume that those people charged with its implementation will educate debtors who come seeking help? If so, to what extent, and is this the sole area in which the court might be expected to operate in restoring the debtor to economic health or is the intent or expectation that efforts will also be made to change attitudes and values? If rehabilitation is taken in its narrowest sense to mean restoration of the petitioner to a former debt-free status, then the court need only lead him through each step of bankruptcy or Chapter XIII proceedings [6] and it has finished its job. However, if the Act commissioned the court to administer the system in such a way that the debtor is restored to a "healthy *working* state", Webster's third definition of the word, then it is the debtor's behaviour and not his state of being that the court must affect. This is not simply a matter of semantics. Rendering an individual debt-free *could* be accepted as a rehabilitative procedure. This would, at the same time, obviate the need for further research or even discussion. However, if there has been little research, there has been much discussion. Whether pro or con (Chapter XIII) and whatever the understanding of the meaning of rehabilitation, authorities addressing themselves to this subject clearly endorse the broader definition; and if the court is charged with influencing behaviour, economic behaviour after bankruptcy must be considered in any evaluative study of the system. Since there is ample evidence from the social sciences that attitudes and values have a significant effect on any complex behaviour pattern, it follows that an enlightened court can also justify adopting procedures calculated to influence debtors' economic attitudes and values, and research must, in turn, focus on changes in attitudes and values.[7]

2.1.20 *The Stigma of Bankruptcy:* An underlying assumption of the *Bankruptcy Act* is that there is an economic and social stigma attached to bankruptcy. Until recently, most people took pride in paying their debts and it was a matter of shame for them and their families when they could not. This attitude towards work and debt often had a religious sanctification. In Genesis, for example, it is written "In the sweat of thy face shalt thou eat bred . . ."[8] and Emerson's maxim was "wilt thou seal up the avenues of ill? Pay every debt as if God wrote the bill."[9] In the case of those for whom the stigma was real, there was an acceptance of responsibility for one's conduct and the results of it. The disgrace of bankruptcy, more than any legal sanction, effectively removed the bankrupt from business and thereby protected both the business community and the public from the incompetent or dishonest businessman.

2.1.21 In our modern society, there are increasingly fewer people who regard work either as a means of serving God or as an end in itself. Work is more often regarded as a necessary evil or as means to securing economic well-being. At the same time, there is a tendency to give more weight to those factors that encourage

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[6] Chapter XIII of the *United States Act* provides a procedure for the consolidation of debts of wage-earners.

[7] J. LEE, *What Shall We Do For The Consumer Bankrupt?* in 44 *Journal of the National Conference of Referees in Bankruptcy,* January, 1970, p. 13, f.n. 12. The italics are those of the author.

[8] *The Bible,* Authorized King James Version, 3 Genesis 19, Toronto, Oxford University Press, 1941.

[9] EMERSON, *Suum Cuique,* cited in Hoyt's *New Cyclopedia of Practical Quotations,* Funk and Wagnall's Co., 1927, p. 181.

the diminution of the responsibility of the individual. It is also becoming apparent that there is an increasing number of persons who more readily accept bankruptcy as a solution to their financial problems. To many, what is legally right is morally right and individual bankruptcy is not a disgrace but just smart business tactics.[10]

2.1.22 The changing attitude of society towards bankruptcy is probably the principal reason for the failure of the present system of the conditional discharge of bankrupts to function effectively. Many choose to remain bankrupt rather than to meet the conditions that may have been imposed. They are more interested in living on a week to week basis than in accumulating assets that could vest in the trustee.

2.1.23 *The Secured Creditor:* When the first Canadian *Bankruptcy Act* was enacted, most creditors were unsecured and the amount owed to secured creditors was often only a small part of the total debt. This may be one of the reasons why the bankruptcy and insolvency legislation interferes so little with the rights of secured creditors and that they, to all intents and purposes liquidate their security free from the strict control and supervision imposed by the *Bankruptcy Act* and the *Winding-Up Act.*

2.1.24 Over the years, new methods of financing have increased the secured debts of almost all commercial debtors. Much financing is now done through security given under section 88 of the *Bank Act* and through new methods of factoring whereby loans are given by the factor to a vendor on the security of a continuing lien on his inventory and accounts receivable. It is expected that legislation similar to article 9 of the United States *Uniform Commercial Code*[11] will soon be enacted in most provinces. This has already been done in Ontario by the enactment of the *Personal Property Security Act*[12]. Under this type of legislation, it is anticipated that most debtors will have a single major supplier of credit who will usually have a security interest in all of the debtor's inventory and accounts receivable.

2.1.25 The growth of secured financing and the pressure for a uniform system for the single filing of personal property securities may be regarded as a reaction of the business community to the weakening of credit protection. A supplier of unsecured credit needs to know whether the proposed debtor is, in fact, the owner of all what he appears to own. With a multiple system of filing liens, this is often difficult, if not impossible, to ascertain with certainty. The same supplier of credit will also want to be assured that, if his debtor should fail, the bankruptcy system will intervene at the earliest point of time to protect the remaining property of the debtor for his benefit and that of the other creditors. The small dividend,[13] which, on the average, is paid to unsecured creditors, indicates that the *Bankruptcy Act* does little, under modern conditions, to protect unsecured credit. The unsatisfactory system of quickly ascertaining whether a proposed debtor does, in fact, own what he appears to own, and the failure of the bankruptcy system to ensure a

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[10] G.A. BRUNNER, *Personal Bankruptcy: Trends and Characteristics,* Columbus, The Ohio State University, 1965, p. 4.

[11] *Uniform Commercial Code,* art. 9 (1968) (U.S.A.)

[12] *The Personal Property Security Act, 1967,* 15-16 Eliz. II, Ont. S. 1967, C. 73. Not yet proclaimed in force.

[13] See *infra* in 2.2.06.

reasonable dividend to the unsecured supplier of credit, on the failure of the debtor, have greatly increased the risk of the unsecured credit grantor. Where the risk of extending unsecured credit appears too great, secured financing becomes much more attractive.

2.1.26 For all estates closed during 1969, $89,105,473 was paid to secured creditors, while only $31,919,837 was available for the payment of the costs of administration and unsecured debts. These figures do not include the amounts liquidated by secured creditors outside of bankruptcy such as through receiverships and foreclosure.[14]

2.1.27 It would not be surprising if the dollar value of property liquidated annually through receiverships were substantially greater than that liquidated through commercial bankruptcies. *Atlantic Acceptance Corporation Limited* is a case in point. It is the largest single financial failure in Canada with losses in excess of sixty-four million dollars. It is being liquidated by a receiver outside of the provisions of the *Bankruptcy Act.*

2.1.28 It may well be that, if secured financing continues to increase, almost all liquidations of the property of an insolvent commercial debtor, in the not too distant future, will be done outside of the *Bankruptcy Act.* This should cause concern, because, in such type of liquidation, there are not the controls and protection that are available under the *Bankruptcy Act.* In these circumstances, the senior secured creditor may, for example, liquidate the security for an amount sufficient only to pay himself in full, with no regard to the position of the other creditors.

2.1.29 To a great extent, what has been said regarding commercial debtors is equally applicable to consumer debtors. More of their indebtedness is secured resulting in repossessions and liquidations outside of the bankruptcy process. Motor cars, furniture and the larger household appliances are sold under conditional sale agreements whereby the title is reserved in the vendor until the full price is paid. The property owned outright by a consumer is very often taken as security, when, hard pressed to keep up payments, he seeks to re-finance his obligations. When the consumer can no longer meet these obligations, the conditional vendor or chattel mortgagee repossesses the property and liquidates it according to his rights. Very often, too, the extent of his secured indebtedness prevents or makes it difficult for the consumer to make an arrangement to pay his creditors over a period of time, as the secured creditors cannot be bound by the arrangement unless they consent.

2.1.30 *The Limited Liability Corporation:* A corporation is a legal entity separate and distinct from its shareholders. As a rule, it is only the corporation that is bound by the action done in its name or on its behalf, and not its shareholders, directors or officers. The abuse of this rule has posed serious problems in bankruptcy administration.

2.1.31 The *Bankruptcy Act* treats corporations in almost all respects as if they were individuals. There are only a very few sections of the Act that deal with the

[14] From the records of the Office of the Superintendent of Bankruptcy.

special circumstances of corporations. Section 118, for example, specifies who must perform the duties of a bankrupt, where the bankrupt is a corporation, and section 162 imposes a penal liability upon officers of a corporation and others who authorize, condone or participate in the commission of an offence.[15] Special rules have also been devised to reach the individuals who control corporations, where dividends have been paid, or shares redeemed, while the corporation was insolvent.[16] Under company legislation, liability is also usually imposed upon directors for the payment of arrears of wages to employees.[17]

2.1.32 In many respects, the *Bankruptcy Act* is ineffective in the case of limited liability corporations. Sanctions against undischarged bankrupts, for example, are meaningless, where the debtor is a corporation. The device of the limited liability corporation is often used to make a mockery of the provisions of the *Bankruptcy Act* designed to keep out of business the dishonest or incompetent businessman. To use the words of Senator David A. Croll, "more and more businesses have clothed themselves in corporate garments which have neither bodies to be kicked nor souls to be damned."[18]

2.1.33 In actual practice, there is little apparent difference between an individual in business, in his own right, and an individual who does business through a limited liability company of which he is the beneficial owner of all of its shares. There is, however, a very real difference when a bankruptcy occurs. In the one case, the individual is required to surrender all of his property that is not exempt from seizure. He may also be refused a discharge or have a discharge granted subject to conditions. This may effectively keep him out of business for some time. In the other case, the individual, on the bankruptcy of his company, may keep all of his own personal property. The company, alone, is required to surrender its property and it is, as a rule, immaterial to the individual whether or not the company is given a discharge. The inconvenience caused to this individual often lasts no longer than it takes to incorporate a new company. The use of a limited company in such a manner can often put the law in disrepute.

2.1.34 The corporate veil has been frequently pierced in company, combines and taxing statutes. Sometimes, this has not been easy to accomplish, but one should not be discouraged, as an English judge once said: "the legislature can forge a sledge-hammer capable of cracking open the corporate shell."[19] A principle that commends itself was contained, some years ago, in the following dictum in the reasons for judgment of a case tried in the United States: "When the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud or defend crime, the law will regard the corporation as an association of persons."[20]

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[15] See also s. 46 of the *Bankruptcy Act* regarding contributory shareholders; R.S.C. 1952, C.14, as amended by 14-15 Eliz. II; Can. S., 1966-67, C.25 and 32.

[16] Section 67B of the *Bankruptcy Act.*

[17] See, for example, *Canada Corporations Act,* R.S.C., 1952, C. 53, S. 97.

[18] CANADA, *Debates of the Senate,* 1962-63, 1st Session, 25th Parliament, p. 111.

[19] *Bank Voor Handel en Scheepvaart* v *Slatford* (1953) 1 Q.B. 248 at 278 (C.A.) per Devlin J. (See generally on this question L.C.B. GOWER, *The Principles of Modern Company Law,* 3rd ed., London, Stevens & Sons, 1969, p. 189).

[20] *U.S.* v. *Milwaukee Refrigerator Transit Co.,* 142 Fed. 247 at 255 (1905).

2.1.35 *Fraud:* More than three hundred years ago, Lord Coke said: ". . . fraud and deceit abound in these days more than in former times."[21] The problem of fraud in bankruptcy administration is still with us. But fraud is not a matter peculiar to bankruptcy. It is, for example, the opinion of J.K. Galbraith that: "As more goods are produced and owned, the greater are the opportunities for fraud and the more property that must be protected. If the provision of public law enforcement services does not keep pace, the counterpart of increased well-being will, we may be certain, be increased crime."[22] Fraud is the crime that characterizes the affluent society. In recent decades, there has been an increasing number of deceptive and fraudulent marketing practices involving merchandise swindles, security frauds, frauds against the consumer and frauds against the government. Immoral and sharp business practices are often increasingly, deliberately and cynically practised.

2.1.36 The temptation to gain at the expense of others is a part of human nature. Thus, the debtor may hide some of his assets on the eve of his bankruptcy. This might take the form of a fraudulent and surreptitious transfer of assets to his wife or his relatives. It can, also, be a concealment of assets or an out and out theft.

2.1.37 Arson used to be a favourite device to wind up an unsuccessful business, permitting the debtor to retire on the proceeds of the fire insurance. Due to the efficiency of public and private investigators, the hazard, to the arsonist, that he will be detected has substantially increased. Sophisticated merchandise swindles have not, however, always attracted the same vigilance of law enforcement agencies. Until recently, criminals could engage in this type of crime without the same risk of detection, arrest and conviction. This has led to the planned bankruptcy.

2.1.38 In the United States, planned bankruptcies have recently been referred to as "the newest and fastest growing business fraud." The scheme has been described as follows:

> In essence, the planned bankruptcy is a merchandising swindle based on the abuse of credit, either legitimately or fraudulently established. The scheme consists of (1) overpurchasing of inventory on credit, (2) sales or other disposition of the merchandise thus obtained, (3) concealment of the proceeds, (4) non-payment of creditors, and finally (5) the filing of an involuntary petition in bankruptcy, by creditors. We refer to this as a planned bankruptcy since, at the very inception of the scheme, the operators make elaborate plans for hiring attorneys and formulate various explanations to be used to describe why assets are not on hand when creditors file the involuntary bankruptcy petition . . . There are indications that upwards of 200 planned bankruptcies a year are inspired, directed and controlled by organized criminal groups (The "Outfit", "Cosa Nostra" or "mafia").[23]

2.1.39 There are "planned bankruptcies" in Canada.[24] The available evidence does not permit us, however, to make an estimate of the frequency with which they

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[21] *Twyne's Case,* 3 Co. Rep. 806; 76 Eng. Rep. 809 at 815 (Star Chamber 1601).

[22] J.K. GALBRAITH, *The Affluent Society,* Boston, Houghton Mifflin Co., 1958, p. 256.

[23] N.E. KOSSACK and S. DAVIDSON, *Bankruptcy: Legal Problems and Fraud Schemes* in *Credit and Financial Management,* May 1966, pp. 30-31. Mr. Kossack was the former Chief of the Fraud Section and First Assistant in the Criminal Division of the United States Department of Justice. Mr. Davidson was an attorney in the Fraud Section of the Criminal Division of the Department of Justice.

[24] See, for example, the recent judgment of *La Reine* v. *Tanguay,* no: 3078/69, Cour des Sessions de la Paix, P. Québec, District de Montréal, 30 janvier 1970.

occur in this country. We must, nonetheless, be prepared to cope with the planned bankruptcy in Canada and, if the weapons at our disposal are not effective, new ones should be designed.

2.1.40 The planned bankruptcy and the other types of fraud so far described have been fraud on the part of the debtor. There also have been instances of fraud on the part of the trustee, creditors and others in connection with the administration of estates in bankruptcy. Property that is not adequately protected and power without adequate supervision are always an invitation to fraud. "Fraud thrives on bad organization, poor administration, unclear responsibility and loose lines of authority."[25]

2.1.41 *International Bankruptcies:* The elements of any bankruptcy are the debtor, his creditors and the property of the debtor. When these are all located in one country, the law of bankruptcy is complex. When the elements involve more than one country, the law is highly complex. The world of today is marked by an intense economic intercourse that is more and more engaged on an international scale. One result of this has been more bankruptcies with international complications, with all the special difficulties associated with them.

2.1.42 In all cases involving matters that, either wholly or in part, arise abroad or involving persons or property situated in a foreign country, a critical question for the Court is to determine whether it has jurisdiction. Once the decision is made that it has jurisdiction, it must then be determined whether it is the duty of that Court to apply domestic or foreign law in the circumstances. Some examples will illustrate the extent of the problem of competence regarding the legal effects of bankruptcy:

(a) what is the legal effect of a bankruptcy in one country upon the status and assets of a debtor in another country?
(b) what is the effect of an arrangement made in one country upon the creditors in another?
(c) what is the position of foreign and domestic creditors in the case where conflicting priorities are given to creditors of the same debtor in bankruptcies in different countries?
(d) what is the international effect of a discharge?

2.1.43 The problems arising out of the conflict of laws, as they relate to bankruptcy, have attracted legal scholars for centuries. Two schools of thought have developed. The one advocates "unity" or "universality", so as to permit a bankruptcy to embrace property outside of the country of the bankruptcy. The

[25] *Problems of Bankruptcy,* Report and Research Proposal of the Brookings Institution, December, 1964, p. 43 (not published); See also G.J. FONZI, *Bankruptcy for Fun and Profit* in *Greater Philadelphia Magazine,* May, 1964, p. 29; N.E. KOSSACK and S. DAVIDSON, *Bankruptcy Fraud: The Unholy Alliance Moves In* in *Credit and Financial Management,* April 1966, p. 20; N.E. KOSSACK and S. DAVIDSON, *Bankruptcy: Legal Problems and Fraud Schemes* in *Credit and Financial Management,* May, 1966, p. 28; N.E. KOSSACK and S. DAVIDSON, *Bankruptcy Fraud,* Sept. 8, 1966, Federal Bar Association Annual Convention; N.E. KOSSACK and S. DAVIDSON, *Bankruptcy Fraud, Alliance for Enforcement* in *Journal of the National Association of Referees in Bankruptcy,* Jan. 1966, p. 12; N.E. KOSSACK, *"Scam" – The Planned Bankruptcy Racket* in *The New York Certified Public Accountant,* June, 1965, p. 417; E.T. SILVERSTEIN, *How to Prevent Credit Frauds* in *Credit and Financial Management,* Oct., 1967, p. 30.

opposing school of thought advocates "territoriality" or "multiplicity", with the result that assets of a debtor in a country other than the country of the bankruptcy are not affected by the bankruptcy and may be freely disposed of by the debtor, but, conversely, are subject to attachment by the creditors of the debtor in the country in which the assets are located.

2.1.44 In theory, the "unity" or "universality" doctrine is more just to creditors, as all of the assets of a debtor in every country are available to all of the creditors. The disadvantage of the application of the universality doctrine is that the creditors of a foreign bankrupt cannot attach the assets of the debtor in their own country and have to prove their claims in the foreign bankruptcy. On the other hand, the application of the territorial principle can give creditors, in one country, the opportunity to gain an advantage over creditors in other countries. This can result, for example, when the country with local assets has the "race is to the swift" system for attachments, which gives the first attaching creditor a higher right than subsequent attaching creditors. The inconveniences of territoriality, however, may be considerably reduced between countries that have relatively the same bankruptcy systems with the same judicial and economic effects. Certainly, the basic aim of equal distribution of all assets among all creditors can be better achieved, when all claims are admitted in all administrations and when the dividends paid in one administration are taken into account in others.

2.1.45 The injustice and inconvenience so often found in international bankruptcies could be reduced through the greater use of bankruptcy treaties. There is no lack of international studies relating to, and precedents for, this type of treaty. France has had a series of conventions with a number of its neighbours, which include the *Franco-Swiss Convention* of June 15, 1869, the *Franco-Belgium Convention* of July 8, 1899, the *Franco-Italian Convention* of June 3, 1930, the *French-Saar Conventions* of March 3, 1950 and of May 20, 1953, and the *Franco-German* treaty on the Saar of October 27, 1956. A convention involving a number of American states, based upon universality, resulted from a conference in Havana in 1921. A treaty between the Netherlands and Belgium concerning territorial jurisdiction in bankruptcy and the execution of judgments was entered into in 1925. Fifteen Latin-American countries, Bolivia, Brazil, Chile, Costa Rica, Cuba, The Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Panama, Peru and Venezuela adhered to the *Bustamante* Code of Private International Law, adopted by the Sixth Pan-American Conference in Havana in 1928. This Code contains conflict rules relating to bankruptcy. For example, where an insolvent has only one domicile, there can be only one bankruptcy comprising all the assets and liabilities in the contracting states. In 1933, Denmark, Finland, Iceland, Norway and Sweden concluded a convention on bankruptcy, based upon the principle of universality. The convention secured the extra-territorial effect in all these countries to a bankruptcy declared by the courts of the debtor domiciled in one of them and provided that all of the assets, wherever located, are at the disposal of the trustee. More recently, the Scandinavian countries have been meeting in an attempt to write a common Bankruptcy Act. A similar attempt, to at least reconcile the different Bankruptcy Acts of its member countries, is being made by the Common Market countries.

2.1.46 It is important, for a trading nation such as Canada, to promote trade and protect its traders. Any uncertainty concerning the nature or application of foreign laws, as they relate to international commercial transactions, may have the effect of restraining trade. One method adopted by Canada to minimize the risk of a Canadian exporter from such unavoidable risks as the insolvency of a foreign buyer was the creation, in 1944, of the *Export Credits Insurance Corporation,*[26] now the *Export Development Corporation*[27]. As the corporation is subrogated to any losses, it can have, and indirectly the Government of Canada as well, a direct financial interest in the bankruptcies of the debtors of the insured exporters.

2.1.47 In 1905, Mr. Justice Nesbitt of the Supreme Court of Canada, when addressing the Universal Congress of Lawyers and Jurists in St. Louis said: "I think that it is a very great pity that there should not be some legislation immediately regulating many questions of International law, at any rate, between Canada and the United States. The growing interchange of business, owing to geographical continuity, makes it very important that there should be well-defined rules applicable to both countries upon many questions which are constantly arising. Take, for instance, bankruptcies, receiverships, administrations."[28]

2.1.48 *World Wide Concern in Bankruptcy and Insolvency Law Reform*: Before concluding this chapter, it should be pointed out that Canada is not alone in its concern about the operation of its bankruptcy and insolvency legislation. In the last few years, France has substantially modified its bankruptcy legislation. Australia appointed a committee in 1956 to review its *Bankruptcy Act*. A report was made in 1962. A new Bankruptcy Act, as recommended by the committee, was enacted in 1966 and came into force in 1968. In 1955, a Bankruptcy Law Amendment Committee was appointed in England. Its report was made in 1957 and has not, as yet, been acted upon. In the United States, the Brookings Institution has been conducting a study of Bankruptcy Problems since 1964. For a number of years the Advisory Committee to the United States Supreme Court on Bankruptcy Rules, which was appointed by Chief Justice Warren in 1960, has been holding regular meetings and its report is not expected before a year or more. Recently, a resolution to create a commission to study the bankruptcy laws of the United States was passed by the United States Congress[29]. Bankruptcy studies have also been made or are still being conducted in Scotland, Eire, Japan and the Scandinavian and the Common Market countries.

2.1.49 *Conclusion*: The many changes that have occurred both in Canada and elsewhere in recent decades, have influenced our way of life, have overburdened the bankruptcy and insolvency system and rendered much of it out of date. Because of the inadequacy of our bankruptcy system and its inability to efficiently and fairly adjust relations between debtors and creditors, justice has suffered. A new bankruptcy system must take into account the new realities.

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[26] *Export Credits Insurance Act,* R.S.C., 1952, C. 105.

[27] *Export Development Act*, 17-18 Eliz. II, Can. S. 1968-1969, C. 39.

[28] In a discussion of *To what extent should Judicial Action by Courts of a Foreign Nation be recognized?* in *Universal Congress of Lawyers and Jurists,* St. Louis, U.S.A., 1905, p. 226.

[29] UNITED STATES, *Senate Joint Resolution 88,* 1st Session, 91st Congress.

CHAPTER 2

WEAKNESSES OF THE PRESENT ADMINISTRATIVE MECHANISMS

2.2.01 The rapid changes that have taken place in our society in recent years have resulted in great pressure on the Canadian bankruptcy system. The basic question is whether the bankruptcy laws are in accord with our times. An important aspect of this question needs to be discussed. Are the mechanisms set up to carry out the purposes and objectives of the legislation adequate and is their control effective? This is of crucial importance in many fields of law, but particularly so in the field of bankruptcy.

2.2.02 The administrative machinery supporting the bankruptcy system can be looked at from two different directions: *firstly*, as it relates to the collective execution process which is a basic element of any bankruptcy system, and, *secondly*, as it relates to the detection and eradication of criminal abuses. This last aspect is discussed at some length, *infra* in 3.4. This chapter examines some of the major weaknesses that afflict the administrative mechanisms of the bankruptcy system as they pertain to the collective execution process.

2.2.03 *Creditor Control*: Bankruptcy legislation varies from country to country regarding the method of control over the administration of an estate in bankruptcy. There may be judicial control, official control or creditor control. In Canada, there has been a wide variation in methods of controlling or supervising administration. They vary from systems of strict creditor control, such as that of the *Bankruptcy Act, 1919,* to court control in proceedings under the *Winding-Up Act, Companies' Creditors Arrangement Act* and *Farmers' Creditors Arrangement Act,* and to a mixture of official and creditor control under the present *Bankruptcy Act.*

2.2.04 Under the present *Bankruptcy Act*, control is given to the creditors, as we have seen *supra* in 1.3., especially in 1.3.09 to 1.3.12. There are many provisions in the Act to encourage creditors as a group and individually, to participate in the administration of an estate. Creditors have the right, for example, to choose the trustee for an estate within the limits of the system requiring trustees to be licensed. The creditors may substitute one trustee for another. In the

administration and distribution of the property of the estate, the trustee must consider the directions of the creditors, so long as the directions are not contrary to the Act. Not only is the trustee bound by these instructions, but in order for his actions to be valid and for him to avoid personal liability, he generally requires specific authorization for important decisions. The trustee is also required to give certain information to the creditors. Furthermore, the creditors may, from time to time, demand that the trustee report on his administration and they may instigate an investigation by applying to the Superintendent or to the court.

2.2.05 The theory of creditor control is that one's interests are best served by oneself. If the creditors are given the means to protect their interests all will be for the best, since the assets of the bankrupt must be liquidated for their benefit. The Act gives to the creditors as much power as is reasonably possible to allow them. Yet, these elaborate provisions for creditor control are illusory, largely by reason of the apathy and indifference of the creditors.

2.2.06 The apathy and indifference of most creditors can be explained by their belief that most trustees are efficient, reliable and experienced in the liquidation of estates. More often, however, the apathy flows from the fact that even the most optimistic creditors expect, at best, a minuscule dividend.[1] Sometimes the hope of realizing a substantial dividend may depend upon the success of a lawsuit, but this hope soon dissipates due to lack of funds to finance it. Thus, creditors are reluctant to take the time to attend meetings of creditors or inspectors, which, in their opinion, could be more usefully spent in attending to their other affairs.

2.2.07 The lack of substantial dividends may be explained, in part, by the increasing number of securities and the proliferation and importance of priorities, especially those of the governments. Another reason which has already been discussed *supra* in 2.1.05 and 2.1.06 is the tendency of most manufactured goods to have a high degree of built-in obsolescence which causes them to depreciate rapidly, especially in the hands of a trustee.

2.2.08 The fact that certain business creditors, at least, have an opportunity to provide for bad debts when they fix their prices and that, moreover, losses are deductible for income tax purposes, can also explain the lack of interest of creditors in bankruptcy administration.

2.2.09 *Growth in, and Need for, Official Control*: To offset the indifference of creditors in supervising the administration of an estate and to control abuses in administration, greater powers have been given from time to time to the Superintendent. The supervision of the bankruptcy process by an impartial person such as the Superintendent is needed to prevent improper and illegal practices and to maintain public confidence. There is, at the same time, an element of judicial control that permits the courts to review the actions and decisions of the creditors and the trustee. But this official and judicial control is not sufficient, as we shall see, to remedy some of the fundamental weaknesses of the system.

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[1] In 1968, unsecured creditors, including those that are preferred, received, on the average, a total dividend of something less than six cents on the dollar.

2.2.10 *The Choice of the Trustee*: The practice in the appointment of trustees is not what, in theory, it was contemplated to be. The official receiver, in the case of an assignment, is required to select and appoint a trustee "by reference to the wishes of the most interested creditors"[2]. The court, in the case of a receiving order, is required to appoint a trustee "having regard, as far as the court deems just, to the wishes of the creditors"[3]. Neither the official receiver nor the court have the facilities nor the time to ascertain who are the creditors and what is their wish concerning the appointment of a trustee. Therefore, in practice, the trustee appointed, in the case of a receiving order, is the trustee nominated by the petitioning creditor. In the case of an assignment, the trustee who is appointed is the trustee nominated by the debtor.

2.2.11 The importance of this can be measured when one realizes that more than 90% of the bankruptcies result from the debtor filing an assignment[4]. This in effect means that, in these cases, the trustee is the choice of the debtor or of his solicitor. Under these circumstances, trustees may be tempted to behave, either deliberately or unconsciously, as if their duty was primarily to the debtor and not to the creditors. Trustees have a key role to play in the administration of estates in bankruptcy. The fact that the trustee owes his appointment to the debtor or the debtor's solicitor is likely to affect his whole approach to such crucial phases of his administration as the taking of the inventory of the debtor's property, the taking of possession of that property, the report that the trustee makes to the creditors at the first meeting, and, generally, his whole relationship with the debtor and the creditors. It seems to us that the law should avoid placing trustees in such a position.

2.2.12 *Bankruptcy and the Debtor with no Assets*: If an insolvent debtor has no assets that, when liquidated, are sufficient to pay the fee of a trustee[5], or if he cannot borrow the amount of the estimated fee or obtain the guaranty of a friend or relative to pay it, there is no way that the debtor may voluntarily become bankrupt. In the result, many small debtors overburdened with debts and with no reasonable expectation of being in a position to improve their financial situation are, in effect, denied the protection of the *Bankruptcy Act* and the opportunity to rehabilitate themselves. This leaves the field opened to abuses. Debtors could be tempted, for example, to obtain a loan from commercial firms for the purpose of their paying the trustee's fees, without disclosing to the lender their intention to go bankrupt immediately on receipt of the loan. Surely, insolvent debtors should be allowed the protection of the *Bankruptcy* Act without having to resort to this kind of practice.

2.2.13 Even more serious abuses can result from a system that makes it too difficult for a debtor to become bankrupt. Some debtors may deliberately resort to

[2]Section 26(4) of the *Bankruptcy Act*, R.S.C. 1952, C. 14, as amended by 14-15 Eliz. II, Can. S., 1966-67, C. 25 and 32.

[3]Section 21(9) of the *Act*.

[4]For 1969, of the 2,284 business bankruptcies reported, 195 or 9% were initiated by receiving orders. Only 14, or less than 0.9%, out of the 1,725 non business bankruptcies, were commenced by receiving orders. (From the records of the office of the Superintendent of Bankruptcy.)

[5]The trustee's fees vary between $350 and $1,000.00 in no-asset cases.

crime in an attempt to solve their financial difficulties. But they may also become, perhaps quite unwillingly, an easy victim for those, such as loan sharks and their associates, who are prepared to provide financial assistance to the needy ones in return for "small" services necessary for the furtherance of their illegal activities.

2.2.14 Similarly, where the debtor has no apparent assets, he can be put in bankruptcy only if the petitioning creditor agrees to guarantee the fee of a trustee. This is not likely to happen very often as the creditor may feel that he is putting up good money after bad. Thus, the very worst type of debtor may avoid being put into bankruptcy and, thereby, avoid the status and restrictions of a bankrupt, if he has taken the precaution to conceal or dissipate all of his assets.

2.2.15 *The Making of an Inventory and Taking Possession of the Debtor's Property*: Under the present Act, the trustee named in the receiving order or assignment is required, "as soon as may be",[6] to take possession of all the property of the bankrupt and to make an inventory. The making of an inventory is, of course, a key element of the administration of the trustee, as it provides evidence of the property in possession of the debtor at the time of his bankruptcy. The inventory is also essential, insofar as the trustee himself is concerned, as it serves as the basis for the accounts that he will eventually submit to the creditors.

2.2.16 It is a basic duty of any trustee to keep an accurate account of the property entrusted to him and to be always ready to render it when required. There cannot be an effective supervision of the administration of an estate or an adequate control over the accuracy of the accounts unless there is the means to identify exactly what property has come into the possession of the trustee and how it was disposed of. It is relevant to recall that trustees are, in effect, appointed in accordance with the choice of debtors in the great majority of cases, as we have seen *supra* in 2.2.11. This in itself seems to us a most difficult position for trustees to be in.

2.2.17 Not too long ago, it was not uncommon for inventories prepared by trustees to be undated and unsigned. In a few cases where trustees had converted property of the bankrupt to their own use, it has been impossible to prove the extent of the conversion, by reason of the difficulty of ascertaining what property the trustee had, in fact, received.

2.2.18 Some of the steps taken by the Superintendent, in recent years, have improved the situation in respect of this important aspect of the trustee's administration.[7] But this does not seem to be sufficient. Some fundamental aspects of the system appear to be defective. From time to time, the Superintendent has received complaints suggesting, for example, that estate assets are tampered with, with or without the knowledge of the trustee, so that prospective bidders, on examination of the assets, will see only defective or incomplete equipment. Some suggestions have been made, as well, that "group" practices exist involving ordinarily a lawyer, a credit bureau, an auctioneer and a trustee, and that only the

[6] Section 8(2) of the *Act*.

[7] See, for example, *Bulletin to trustees No. 11*, issued by the Superintendent of Bankruptcy on July 28, 1969.

"group" would know exactly what the inventory consists of. The trustee and the lawyer would steer business into the "group". The credit bureau could get its man appointed as an inspector to reinforce the "group" pressure. Trustees would open bids privately and inform the "group" of the results, so that they may have the opportunity to put in a higher bid.[8] When sealed bids are not opened before the inspectors, the trustee, the suggestion goes on, would have the opportunity to produce hidden bids from the "group". Even where sealed bids are opened before the inspectors, he would declare the bids not high enough if the "group" was unsuccessful. The trustee would then call for new tenders. The "group" would then have the information on the other bids and be in the position to be successful on the second tender.

2.2.19 It is the responsibility of the Superintendent of Bankruptcy to investigate this kind of abuse. There is no definite evidence that trustees do, in fact, indulge in these practices. It should be recognized, however, that this kind of abuse is most difficult to substantiate. The system is such that these abuses could well be taking place without the authorities being in a position to substantiate them. Certainly, such a system can only generate distrust and dissatisfaction that reflect on the whole bankruptcy administration. This may well be another contributing factor in the creditors' lack of interest in bankruptcy administration.

2.2.20 *Meeting of Creditors*: One of the first duties of the trustee is to inform himself of the names and addresses of the creditors and thereupon to call a meeting. The meeting is presided over by the official receiver or his nominee. Its purpose is to consider the affairs of the bankrupt, affirm the appointment of the trustee or substitute another in place thereof, to appoint inspectors and to give directions to the trustee with respect to the administration of the estate. If a quorum of at least three creditors or all of the creditors, when their number does not exceed three, is not present, the meeting is not competent to act for any purpose except to adjourn the meeting.

2.2.21 A recurring problem, in recent years, has been the difficulty of obtaining a quorum at the first meeting in almost all but the large estates.[9] This has the effect of delaying administration during the first, and often critical, few weeks. As we have already seen, there are a number of reasons to explain the lack of interest on the part of the creditors. But the fact remains that the requirements of the Act regarding the first meeting of creditors, in many cases, do not work. Because of the general lack of interest on the part of creditors, the checks and balances on the powers of the trustee, that the meetings were designed to provide, do not operate.

2.2.22 *The Board of Inspectors*: The purpose of a Board of Inspectors is to permit the creditors, through the inspectors, to closely control the administration. It was

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[8] *Bulletin to trustees No. 12*, issued by the Superintendent of Bankruptcy on May 6, 1970, which prescribes a procedure to be followed by trustees when tenders are asked, should improve the situation in this respect.

[9] The records from the Office of the Superintendent of Bankruptcy show that, out of 964 summary administrations filed with the Official Receivers of the Bankruptcy Divisions of Montreal, Toronto and Vancouver during 1969, there was no quorum at the first meeting of creditors in 624 cases. Even after sending a second notice convening these creditors to a meeting, a quorum was obtained in only 37 of those cases.

no doubt thought that the leadership and initiative for an efficient administration of the estate would come from them. In other times, when perhaps there was a greater interest on the part of creditors, this might have been the case. Undoubtedly, this leadership and initiative are sometimes forthcoming today. Certainly almost every experienced trustee can tell of the invaluable assistance he has received from his inspectors at one time or another. Many trustees also have a feeling of security in the fact that they are not making decisions alone and that they have received or will receive the approval of the inspectors for everything they have done or will do. But for every case that a trustee can recount where he has benefited by the board of inspectors, he will tell of the times that the administration of an estate was delayed or hindered by the difficulty in obtaining a quorum of inspectors. There is no doubt that inspectors can make a very valuable contribution to an estate, but the question may be asked whether it is realistic to provide, as the present Act does, that there be inspectors in all ordinary estates, whether or not the creditors are interested in having inspectors appointed.

2.2.23 The insistence of the law in making the appointment of inspectors mandatory in the case of ordinary estates does not necessarily result in the appointment of qualified and conscientious inspectors. Where it is possible to find inspectors to act, they often rapidly lose all interest in the administration of the estate and just become the blind servants of the trustee. The result is that the checks on the powers of the trustee that this mechanism was designed to provide do not come into play.

2.2.24 *Conflicts of Interests*: Some of the most serious and pervasive weaknesses of the system relate to the numerous situations of conflicts of interest that proliferate in bankruptcy administration and that, generally speaking, the law fails to recognize. Even the best system would suffer from the distortions brought about by the various unregulated conflicts of interest in which those who have key roles to play find themselves.

2.2.25 *Conflicts of Interests Involving Lawyers*: In proceedings under the *Winding-Up Act* and, to a lesser degree, under the *Companies' Creditors Arrangement Act*, the administration is especially legalistic due to the formalities of procedure and the necessity for frequent applications to the court. The *Bankruptcy Act* does not contemplate that lawyers will play any part in bankruptcy administration. In practice, their role is often of prime importance and their fees are not infrequently the largest single item of expense.[10] With the major role that lawyers, in fact, have in bankruptcy administration, they often find themselves in positions of conflicts of interests.

2.2.26 Trustees are not unmindful that, in most cases, they have been recommended by the solicitor for the petitioning creditor, in the case of an involuntary bankruptcy, or the solicitor for the debtor, in the case of an assignment or voluntary bankruptcy. In recognition of this fact, the solicitor who, in fact, has

[10]The total legal fees for all estates closed in 1969 amounted to $1,740,785, or 12.6% of the total administrative expenses which amounted to $13,733,594. (From the records of the Office of the Superintendent of Bankruptcy.)

recommended the trustee, is very often appointed the estate solicitor. The dangers inherent in such a practice were vigorously stated by the late Chief Justice Taft:

> Many abuses have occurred in the bankruptcy practice; and none is more frequent than that by which the attorney for petitioning creditors becomes counsel for the trustees subsequently appointed. This mingling of interests, frequently conflicting, is generally regarded by courts as working to the detriment of one of the parties and to the undue advantage of another. Experience has shown the wisdom and necessity of separating the function and obligation of counsel by forbidding the employment in different interests of the same person . . . The danger of giving entire freedom of selection of counsel to trustees lies in the temptation of the attorney for some creditors when he becomes counsel for the trustees, to use his function as representative of all the creditors, unjustly to favour or oppose particular creditors or to induce the trustees to do so.[11]

2.2.27 *Conflicts of Interests Involving Trustees and Creditors*: The draftsmen of the present *Bankruptcy Act* were not unaware of the problems that could result from conflicts of interest. The Act provides, for example, that a debtor, in making an assignment, must leave the name of the trustee in blank and the official receiver, as we have seen, is required to select a trustee and fill his name in the assignment, having regard "to the most interested creditors if ascertainable at the time".[12] Where a receiving order is made, the court appoints a trustee "having regard, as far as the court deems just, to the wishes of the creditors".[13] A person "who is a party to a contested action or proceedings by or against the estate"[14] may not be an inspector. Similarly, an inspector may not acquire for himself or another, directly or indirectly, without the permission of the court, "any of the property of the estate for which he is an inspector".[15] Except for these provisions, there is, however, no direct prohibition against any person involved in the administration of an estate from putting himself in a position of a conflict of interest. The person who acted as the accountant of the debtor before the bankruptcy is not precluded from being the trustee in the bankruptcy of the debtor. A trustee who is responsible for the liquidation of the estate for the benefit of the unsecured creditors may and often does act as the agent for a secured creditor, such as a bank, for the liquidation of its security. In such cases, the trustee may be required, in the interest of the unsecured creditors, to attack the security agreement, while the interest of the secured creditor may dictate that the trustee should not examine carefully the validity of the security. Wherever one is in a position of conflict of interest, there is a danger that there will be abuse of power, damaging compromises and a loss of public confidence in the system.

2.2.28 *Creditor Control is a Myth*: While, in theory, the creditors are primarily responsible for the administration of the estates, it is difficult not to come to the conclusion that, in most cases, creditor control is a myth. Notwithstanding the elaborate provisions designed to give creditors the control and supervision of the administration of estates, in actual practice, the trustee and, where there is a solicitor to the estate, the solicitor make most administrative decisions. These

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[11] *Weil* v. *Neary* (1928) 278 U.S. 160 at 168. The rules of some Bar Associations prohibit lawyers from getting involved in situations where there may be a conflict of interest. See, for example, the *By-laws of the Bar of the Province of Quebec*, s. 56.

[12] Section 26(4) of the *Bankruptcy Act*.

[13] Section 21(9) of the *Bankruptcy Act*.

[14] Section 82(2) of the *Bankruptcy Act*.

[15] Section 82(11) of the *Bankruptcy Act*.

decisions, for the most part, are uncritically approved by the inspectors who often see the time involved in performing their duties as a waste of their time. The tendency is, therefore, to leave the administration of the estate to the trustee and the lawyer. This is far from the creditor control contemplated by the legislator.

2.2.29 *The Role of the State*: Apart from the role of the Superintendent of Bankruptcy in the detection and eradication of criminal abuses (*infra* in 3.4.), the Superintendent, generally, is not directly involved in the administration of estates. He has some responsibility, however, in the licensing of trustees and important duties in ensuring that licensed trustees deserve the confidence of the public. It is also his responsibility to comment, for the benefit of the court, on the statements of accounts prepared by trustees when their administration is completed.

2.2.30 *The Licensing of Trustees*: All licences and renewals of licences to act as trustee under the *Bankruptcy Act* are issued by the Superintendent on the authorization of the Minister of Consumer and Corporate Affairs. The suspension or cancellation of a licence is the prerogative of the Minister who acts on the advice and recommendation of the Superintendent.

2.2.31 For a period of two years, starting in 1965, a moratorium was imposed on the issuance of new licences. In the latter part of 1967, new criteria for the selection of trustees were adopted.[16] This new policy has now been in force for a couple of years and the indications are that it has contributed to the upgrading of the general standards of performance of trustees.

2.2.32 It has always been one of the key responsibilities of the Superintendent to supervise the administration of trustees and ensure that they deserve the trust placed in them. The statistics published by the Superintendent indicate that a rather large number of licences have been withdrawn or restricted especially since early in 1960.[17] This action was necessary to eliminate the undesirable persons that had succeeded in getting a licence. There is, however, in this respect, one matter that deserves mention, that is, the inadequacy of the provisions of the Act regarding the procedure leading to a cancellation of, or restrictions being imposed on, a trustee licence.

2.2.33 The provisions of the Act do not provide an entirely adequate protection to trustees whose licences are either restricted or suspended.[18] This is especially so where a trustee's licence is not renewed. The Department has always taken great care to ensure a fair hearing to trustees before taking action on a licence, but the lack of formal prescriptions in the law, in this respect, is understandably a cause of dissatisfaction among trustees. Similarly, it is understandable that some would be concerned by the fact that the Superintendent has the responsibility for launching and making investigations, for reporting to the Minister and for recommending whether any action should be taken in respect of the licence. It may validly be argued that there is a need to separate, to a greater degree than is the case now, the

[16] For the details of this policy, see the *Report of the Superintendent of Bankruptcy* for the year ended March 31, 1968.
[17] See the *Report of the Superintendent of Bankruptcy* for the year ended March 31, 1968.
[18] Sections 5(4) and 6 of the *Bankruptcy Act*.

investigation function from the adjudicating function in the procedure leading to the cancellation or suspension of a trustee's licence.

2.2.34 *The Bonding of Trustees*: Another problem that is worth mentioning here relates to the difficulties of obtaining satisfaction from bonding companies in cases where trustees have been guilty of misappropriation of funds or other fraud. Trustees are required to file with the Superintendent a general security for the due and faithful performance of their duties,[19] as well as, with the official receiver, a more specific bond for each ordinary estate administered by them. The experience of the last few years has shown that, in many cases, it is extremely difficult to collect on these securities, which have been mostly, until recent years, in the form of bonds issued by insurance companies. There is no doubt that the insurance companies have the right, and indeed the responsibility, to satisfy themselves that the amounts claimed are really and legally due, but it remains that what was sought to afford good and adequate protection for creditors against the wrongdoing of trustees has turned out, often, to be more or less illusory, especially when it takes many years to obtain the final settlement of a claim.

2.2.35 *The Taxation of Accounts*: The Superintendent of Bankruptcy has the responsibility, under section III of the Act, to examine every statement of receipts and disbursements and the final dividend sheet prepared by trustees at the end of their administration. In appropriate cases, he may comment upon these documents. These comments are transmitted to the taxing officer to be considered on the passing of the trustee's accounts and his application for discharge.

2.2.36 The present procedure, which requires the Superintendent to comment on the trustee's statement of receipts and disbursements and the final dividend sheet while their approval is left to the taxing officer, is unnecessarily complicated and onerous. There does not seem to be any valid reason why, after having come to the Superintendent for his comments, the trustee should be required to appear before the taxing officer to have his accounts passed. The present procedure is not only wasteful, but it creates uncertainties in the mind of those discharging these functions, as to where the responsibility lies. One authority may well believe that the other has satisfied itself, or will satisfy itself, that a particular item in the statement is in order, which may well not be the case.

2.2.37 One of the difficulties, under the present system, is the lack of uniformity that characterizes the manner in which the many taxing officers across the country exercise their discretion. This now varies greatly, not only between taxing officers in different provinces, but often in the same province. The result is often inequity for the creditors, and, at times, for the trustees themselves.

2.2.38 Every solicitor's bill of costs is served upon the Superintendent and, if he considers it advisable, he may intervene on the taxation. As a matter of practice, the Superintendent will intervene only in those cases where it appears that the bill of costs is clearly out of line in view of the services that, according to the information available, have been rendered. The policy of the Superintendent to

[19] Section 5(1) of the *Act*.

intervene in such cases is relatively recent. It was made possible through an amendment to the Rules enacted under the *Bankruptcy Act*, made in 1968, that requires a solicitor to give to the Superintendent ten days' notice of the time and place of taxation.[20]

2.2.39 Before the solicitor for an estate may have his bill of costs taxed, he must first submit his account to the trustee for approval and comments.[21] In many cases, this approval is perfunctorily given when the assets of the estate are sufficient. As we have already seen, the solicitor and the trustee are not at arm's length, as it is the solicitor who often, in fact, chooses the trustee by recommending him to his client. In turn, the trustee will very often choose the solicitor who was instrumental in having him appointed, to act for the estate. Under such circumstances, the trustee may not be inclined to examine, in a meaningful way, the solicitor's bill, by fear that, if he does, the chances that he will ever be chosen to be the trustee in any new bankruptcy in which that solicitor is associated, in all likelihood, will be small.

2.2.40 The power of the Superintendent to intervene is not, by any means, a cure-all. As it was already noted, the Superintendent, in practice, intervenes only in what appears to be the most flagrant cases of abuse. He does, however, examine every solicitor's bill of costs and, as in the case of trustees' accounts, there is some duplication and waste involved in the work of the Superintendent and that of the taxing officer in that respect. Finally, as in the case of the trustees' statements of accounts, lack of uniformity of approach characterizes the manner in which the taxing officers use their discretion in the passing of solicitors' bills of costs.

2.2.41 *Conclusion*: The weaknesses of the administrative mechanism described in this chapter are serious and have considerably contributed to bringing into disrepute the Canadian bankruptcy system. Creditors have, in our view, shown, over the last few decades, that, in general, they are not genuinely interested in involving themselves in the administration of the bankruptcy system. Obviously, creditor control is not adequate, and other avenues must be explored and other means to improve the administration must be devised, if the public is to again have confidence in the system.

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[20] P.C. 1968-1080, June 5, 1968.

[21] Rule 43 of the Rules enacted under the *Bankruptcy Act*, P.C. 1954-1976.

CHAPTER 3

TECHNICAL DEFICIENCIES IN THE PRESENT LEGISLATION

2.3.01 The previous chapters show that many of the concepts inherent in the present bankruptcy and insolvency legislation are anachronistic. In addition, and as a result of our changing society, the legislation is often silent in many respects of vital concern. There is also, in the legislation and especially in the *Bankruptcy Act,* many technical and drafting deficiencies. In many respects, the arrangement of the Act is confusing and illogical. Some sections, for instance, do not have the clarity and precision one would expect; others are either meaningless or do not express the intention of the draftsmen. Lord Mansfield C.J. once observed that "it would be very hard on the profession, if the law was so certain, that everybody knew it; the misfortune is that it is so uncertain, that it costs much money to know what it is, even in the last resort"[1]. He might have been referring to the present *Bankruptcy Act.*

2.3.02 *Arrangement of the Act*: The Act is divided into ten parts, supposedly for the convenience of reference. One would, therefore, expect to find all of the sections relating to one subject in one Part of the Act and, preferably, all in one particular group of sections. This, however, is not the case. Sections 95 to 106, for example, would appear to establish a comprehensive scheme of distribution. This is deceptive as the scheme is not complete. For instance, subsection 4 of section 42 creates a first charge for the costs of distress and sale; section 61 contains a provision postponing, until all other claims have been satisfied, the dividend on a claim arising out of liability to make a future payment or transfer of property under a marriage contract. Similarly, subsection 6 of section 155 sets out the order in which five particular kinds of legal costs are to be paid. Another example of poor arrangement of the Act relates to the powers of an interim receiver which are found in subsection 2 of section 11 and section 24.

2.3.03 *Imprecisions:* Sections 71 to 81 provide the procedure for calling and conducting meetings. In reading these sections, it is difficult, if not impossible, to

[1] *Jones* v *Randall,* (1774) 1 Cowp. 37, at 40; 98 Eng. Rep. 954.

know whether certain sections refer to a first meeting of creditors, any other meeting of creditors, a meeting of inspectors or all of them.

2.3.04 The section of the Act, which is the least precise and has caused much confusion, is subsection 1 of section 38, which provides that "All of the provisions of this Act, insofar as they are applicable, apply *mutatis mutandis* to proposals". The words "insofar as they are applicable", which limit the application of *"mutatis mutandis"*, have caused much difficulty. For many sections of the Act, it is impossible to say with any degree of certainty whether or not they apply to proposals.[2]

2.3.05 The reference to "such date" in paragraph (a), subsection 2 of section 40 is confusing. The paragraph refers to a security for a debt due at the "date of the bankruptcy" or "not later than six months thereafter". It then states that the right to realize shall not be postponed for more than six months from "such date". What date? This same confusing use of "such date" is also used in paragraph (b), subsection 2 of section 40.

2.3.06 Senator Fogo, in the second reading of the Bill for the 1949 Act, said:

> . . .Section 64 of the bill, which deals with fraudulent preferences, contains quite substantial changes. An endeavour has been made to avoid the many instances of litigation arising out of administration of estates. Perhaps I should read section 64(1). It is as follows:
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> > Every transaction, whether or not entered into voluntarily or under pressure, by an insolvent person who becomes bankrupt within six months thereafter and resulting in any person or any creditor or any person in trust for such creditor or any surety or guarantor for the debt due to such creditor obtaining a preference, advantage or benefit over the creditors or any of them, is void against the trustee.
>
> The new words of significance are "resulting in any person getting a preference". The previous section, also numbered 64, was somewhat differently worded, but the operative words to which I direct your attention in the old section read, "with a view of giving such creditor a preference". This new section therefore, appears to have removed the necessity for determining the intent of the bankrupt, and, as was the law in certain provinces, of the creditor concerned. Some differences had arisen in the jurisprudence as between provinces. In some provinces the doctrine of concurrent intent was developed and the courts were inclined to look not only at the intent of the insolvent but also at the intent of the creditor who got the preference. No doubt this new section 64 will be discussed in committee. Obviously the intention is to remove the uncertainty which everyone familiar with bankruptcy laws knows existed under the former section. It has been argued, and no doubt will be argued again, that where a body of law has been built up around the old section 64, and some people at least know what they think the law is, it ought not to be changed even though the new Act may be admitted to be an improvement.[3]

Unfortunately, "certainty" was sacrificed for "the body of law" and this new section 64 was removed from the Bill at the committee stage. As a result there has been more than twenty years of additional uncertainty over the meaning of this section. The words of an ancient author have a very modern sound in this regard: "For certainty is the father of right and the mother of justice".[4]

2.3.07 Section 65 is another example of an uncertain and confusing section. It purports to temper the severity of the relation back of the title of the trustee, from

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[2] A recent example of this can be found in the reasons for judgment of O'Connor J. in *Re: Coupal et Frères Ltée* (1969), 12 C.B.R. (N.S.) 28.

[3] CANADA, *Debates of the Senate*, 1949, 2nd Session, 21st Parliament, p. 98.

[4] Probably Baron FORTESCUE, but see HEARD, *Oddities of the Law* (1921), p. 183.

the date the receiving order was made, to the date the petition for a receiving order was filed. What the section, no doubt, meant to say was that a payment, for example, made by a bankrupt between the date of the filing of the petition against him and the date of the receiving order would, in certain cases, not be considered preferential. However, instead of saying the "date of the receiving order", section 65 refers to the "date of the bankruptcy" which is defined by subsection 4 of section 41 to be the date of the filing of the petition. For some time, the tendency of the courts was to hold that the provisions contained in section 65 were exceptions to those contained in section 64[5]. To give this interpretation of section 65 presents however a number of difficulties. Under such an interpretation, the section would, in effect, provide that a payment made before the date of the bankruptcy, under certain conditions, would not be invalidated. It should be pointed out, however, that, in most cases, the payment would be invalidated, only if it was a voidable preference as defined by the Act. Section 65 is prefaced by the words "Subject to the foregoing provisions of this Act with respect to . . . the avoidance of . . . preferences . . . " Thus, one would be led to conclude that, after going into some detail to describe payments that will not be invalidated, the section specifically reserves the right of the court to invalidate payments that the section states would not be invalidated. Another approach to the interpretation of section 65 was developed by the courts pursuant to which section 65 would have no bearing on the interpretation to be given to section 64[6]. The difficulty, of course, with this interpretation is that, because of the use of the words "before the date of the bankruptcy", instead of "before the date of the receiving order", the section can protect only payments made before the filing of the petition for a receiving order. As a result, one could argue that payments made by the debtor, between the filing of the petition and the making of the receiving order, even if they meet the conditions set out in section 65, would be void and third parties that have dealt with the debtor in good faith during that period would be left without protection.

2.3.08 *Sections which Have Meanings other than as Intended:* Subsection 8 of section 19 purports to discharge a trustee from "all liability in respect of any act done or default made by him in the administration of the property of the bankrupt . . . " What was no doubt intended was to discharge the trustee from all liabilities to the beneficiaries of the trust and not to third parties. It may be argued that the present section could give a trustee, who is driving the bankrupt's motor car to a place where it is to be sold, a complete release for all liability resulting from an accident caused by his fault. Obviously, this could not have been the intention of the legislature.

2.3.09 Subsection 7 of section 6 states that "no defect or irregularity in the appointment of a trustee shall vitiate any act done by him in good faith". Literally, this section means that, if acts are done by the trustee in "bad faith", that is, with the knowledge of the defect or irregularity that affects his appointment, they are

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[5]See, for example, *In re Vogue Fur Shop Ltd., ex p. Paquet Co. Ltd.,* (1925) 1 D.L.R. 785; 5 C.B.R. 386.

[6]See, for example, *Re Echlin Press Limited: Taylor* v *Hamilton Ruling and Bindery Service Limited,* 1968 11 C.B.R. 258, p. 263.

vitiated, even though the other party may be in good faith. By the same token, if the party who is dealing with the trustee is not acting in good faith, that is, with the knowledge of the same defect or irregularity, such an act cannot be vitiated. Obviously, this section was intended to protect the rights of the persons dealing with the trustee in good faith. What should be relevant is the good or bad faith of such persons and not the good or bad faith of the trustee. What the draftsman, no doubt, intended to say is: "No defect or irregularity in the appointment of a trustee shall vitiate any act done by him affecting any person who deals with such trustee in good faith." The same question arises with respect to the defect or irregularity in the appointment of inspectors.[7]

2.3.10 Defective definitions may lead to strange conclusions. "Creditor" is defined as a person having a claim under the Act.[8] A "person" is defined to include a corporation.[9] A "corporation" is defined so as to exclude banks, insurance and other companies,[10] and therefore these companies are neither "persons" nor "creditors". But, only a creditor may petition for a receiving order against a debtor.[11] On the face of the Act, these companies, if it were not for section 14 of the *Interpretation Act*[12] could not, therefore, petition for a receiving order. Technically, they would also be excluded, for all purposes, from participating in the administration of the estate. These definitions, designed as tools to help in the interpretation of the Act, have instead contributed to making it more difficult to interpret.

2.3.11 The Act of 1919 created Courts of Bankruptcy and invested them with "such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancillary jurisdiction. . . " [13] Having created a court, it was necessary to define its jurisdiction. The Act, however, was subsequently amended to vest jurisdiction in bankruptcy in the Superior Courts of the provinces. Section 140 still purports to invest the Superior Courts with a jurisdiction "at law and in equity". Obviously, in this context, the word "law" refers to Common Law and the word "equity", to the equitable jurisdiction as developed by the English Court of Equity. This creates an unnecessary complexity. The Superior Courts of the Common Law provinces, which already have jurisdiction in law and in equity by virtue of the *Judicature Acts,* are given a jurisdiction that they already have. The Superior Court of Quebec, which has Civil Law jurisdiction, is given an unneccessary jurisdiction at "law and in equity". In the Common Law provinces, where there is a conflict between a legal and equitable rule, the equitable rule prevails. It may be argued that, in the province of Quebec, the Superior Court of that province can be faced with a Civil Law rule, a Common Law rule and an equitable rule. In case of conflict,

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[7] Section 82(12) of the *Bankruptcy Act,* R.S.C. 1952, C. 14, as amended by 14-15 Eliz. II, Can. S., 1966-67, C. 25 and 32.

[8] Section 2(h) of the *Bankruptcy Act.*

[9] Section 2(m) of the *Bankruptcy Act.*

[10] Section 2(f) of the *Bankruptcy Act.*

[11] Section 21(1) of the *Bankruptcy Act.*

[12] 16-17 Eliz. II, Can. S. 1967-68, C. 7, . . . Where an enactment contains an interpretation section or provision, it shall be read and construed (a) as being applicable *only if the contrary* intention does not appear, . . ."

[13] *The Bankruptcy Act,* 9-10 Geo. V, Can. S. 1919, C. 36, s. 63.

there could be a substantial doubt as to which rule prevails. On the other hand, there is the risk that the word "equity" be interpreted in the province of Quebec in its ordinary meaning, that is to say, as giving to the judge the power to decide according to the general principles of justice as perceived by him.

2.3.12 *Uncritical Use of English Precedents:* Canadian bankruptcy and insolvency legislation has always relied strongly upon English statutes for prototypes. Occasionally, this has caused problems where parts of a statute were adopted without a clear understanding of how they were affected or modified by other parts of the statute which were not adopted. Several examples of this sort of problem in the present *Bankruptcy Act* could be cited, but three examples will suffice.

2.3.13 Subsection 1 of section 42 provides:

> An execution levied by seizure and sale of the property of a bankrupt is not invalid by reason only of its being an act of bankruptcy, and a person who purchases the property in good faith under a sale by the sheriff acquires a good title thereto against the trustee.

This section is almost an exact copy of subsection 3 of section 40 of the *English Act*[14] except that "bankrupt" has been substituted for "debtor". Under the *English Act,* the section is necessary as the trustee's title relates back to and commences at the time of the commission of the act of bankruptcy on which the receiving order is based. The Canadian section is meaningless for two reasons. In the first place, bankruptcy relates back, not to the act of bankruptcy, but to the date the petition is filed. In the second place, by substituting "bankrupt" for "debtor", the impossible situation is contemplated of an act of bankruptcy being committed after the debtor has become bankrupt. This provision, which has a very useful and necessary function under the *English Act,* means nothing in the context of the *Canadian Act.*

2.3.14 When the *Criminal Code* of Canada was enacted in 1892, there was a real attempt to make it an omnibus code to cover all criminal activity, whether theretofore it was the subject of legislation or not. The whole or part of some seventy statutes were incorporated into the code. As there was, at that time, no *Bankruptcy Act* in Canada, the draftsmen looked to the *English Bankruptcy Act* for examples of bankruptcy offences and incorporated some of them into the code. Later, when the *Bankruptcy Act* of 1919 was drafted, the *English Bankruptcy Act* was used as a precedent. As a result and perhaps unwittingly, the fraud sections of that Act, which had previously been incorporated into the new *Criminal Code,* were substantially incorporated into the new *Bankruptcy Act.* The real reason for this duplication is not apparent, in spite of attempts made by judges, lawyers and scholars to rationalize it.[15]

2.3.15 The present Act provides, in subsection 1 of section 75, that, in order to vote at any meeting of creditors, a creditor must lodge a proof of claim with the trustee *before* the time appointed for the meeting. Subsection 2 states that a creditor may vote by proxy. These subsections are adopted word for word from paragraphs 8 and 15 of the First Schedule of the *English Bankruptcy Act.* Rules 252

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[14] 4 and 5 Geo. V, U.K.S. 1914, C. 59.

[15] See, for example, J. COHEN, *The Bankruptcy Act: Criminal Aspects of Bankruptcy Law,* (1956) 16 R. du B. 310.

and 263 of the same Act very sensibly provide that a proof of claim and a proxy should be lodged with the official receiver no later than noon on the day before the meeting. There is no similar rule in Canada. The result is that a proof of claim and a proxy can be lodged with the trustee at the last moment before the meeting. Under these circumstances, if the creditor or a proxy holder wishes to vote at the meeting, the chairman of the meeting can hardly object, as he does not have the time to examine the documents.

2.3.16 *Ineffective Sections*: Some sections of the present Act, through mistakes in drafting, are ineffective. Subsection 1 of section 126 is a case in point. This section provides:

> 126(1) The Court may by warrant cause a ***bankrupt*** to be arrested . . . under the following circumstances:–
>
> (a) if, after the filing of a bankruptcy petition against him, it appears to the court that there are grounds for believing that he has absconded or is about to abscond from Canada with a view of avoiding payment of the debt in respect of which the bankruptcy petition was filed . . .

This section is almost word for word the same as subsection 1 of section 23 of the *English Act.* Since 1919, a comparable section has always been in the *Canadian Act.* Until 1949, the section was meaningful. However, in the 1949 revision, "bankrupt" was substituted for "debtor". This has the effect of completely defeating the intention of the section which is to permit the arrest of a debtor before he is adjudged bankrupt, when there are grounds to believe that he is absconding from Canada with a view of avoiding payment of the debt in respect of which the petition is filed. As the section now reads, before the debtor may be arrested, he must be adjudged bankrupt and, by that time, he may be far away.

2.3.17 It is not uncommon for the principal officer of a corporation, to be the guarantor of loans to the corporation. On the insolvency of the corporation and when bankruptcy appears imminent, the guarantor may often arrange for the corporation to repay the loan to the creditor. This results in the cancellation of the liability of the guarantor and the release of any collateral security given by him to the creditor. This has the effect of giving both the principal creditor and the guarantor a preference over the other creditors. Section 64 of the Act provides for the avoidance of certain preferences and, for these purposes, the applicable words are: ". . . every payment made . . . by any insolvent person in favour of any creditor. . . with a view of giving such creditor (which expression, as defined in subsection 3, includes a surety or guarantor for the debt to such creditor) a preference over the other creditors shall, if the person making. . . the same becomes bankrupt within three months after the date of making . . . the same, be deemed fraudulent and void as against the trustee in the bankruptcy."

2.3.18 It is obviously the intention of subsection 3 of section 64 that, where a payment is made to a principal creditor with the intention of giving to the guarantor a preference over the other creditors and the guarantor has the intention of being preferred, an order for payment to the trustee be made directly against the guarantor. It has been held however that, where there is only one payment and the payment is valid as between the debtor and the principal creditor, it cannot be void as between the debtor and the principal creditor, it cannot be void as between the

guarantor and the trustee.[16] As a result subsection 3 of section 64 does not fulfil its intended purpose.

2.3.19 *Inaccuracy of the French Version of the Act*: The language, syntax and style of the French language version of the Act often leave much to be desired. Several sections, especially sections containing technical expressions in the English version are often obscure, meaningless, or misleading in the French version. Some passages of the French version are often no more than a collection of French words.[17] In section 61, the words "dévolu" and "en réversibilité" may be understood only by reading the English version. Another example that may be given is paragraph (b) of subsection 1 of section 135. In the English version, it reads: "an order of discharge does not release the bankrupt from . . . any debt or liability for alimony." In the French version, "pension alimentaire" is used for alimony. "Pension alimentaire", which is a literal translation of alimony, means much more in civil law than alimony in common law. "Pension alimentaire" includes an alimentary pension to which both a wife or husband may be entitled, where he or she is separate as to bed and board from the other, as well as the obligation of both parents and children for the support of the other. Alimony, on the other hand, in common law has a much more restrictive meaning, as it refers only to a payment from a husband to his wife for her support when they are living separate and apart.

2.3.20 *Omissions:* A number of omissions in the Act have done much to place in doubt the rights of several classes of creditors, particularly hypothecary creditors under the civil law. Although it is the obvious intention of the *Bankruptcy Act* to free the bankrupt from future liability, it is not the intention to disturb the rights of a secured creditor in his security. However, in Quebec, an interesting question arises as to the effect of section 135 and the definition of a provable claim in the case of a hypothecary creditor wanting to enforce his security. A mortgagee, under common law, becomes the owner of the mortgaged property, in the case of a first mortgage, or of the equity of redemption, in the case of subsequent mortgages, the whole subject to the right of the mortgagor to redeem the mortgage on repayment according to the terms of the mortgage. In civil law, a hypothecary creditor is not the owner of the property given as security. On default, the hypothecary creditor may either sue the debtor for the debt or, by way of an hypothecary action, require that the secured property be sold and his debt paid in priority from the proceeds. Section 135 states that an order of discharge releases the bankrupt from all provable claims except in a few specific cases. A provable claim is defined to mean any claim provable by a preferred, secured or unsecured creditor. Some may argue that this has the effect of releasing the debt of a secured creditor on the discharge of the bankrupt, with the result that the hypothecary creditor could no longer sue on the debt. Under common law, this would not prevent the secured creditor from foreclosing the security. However, under civil law, the secured creditor would then have no recourse at all as no hypothecary action may succeed unless there is a principal debt.

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[16] *In re Bernard Motors Ltd.*, (1960) 38 C.B.R. 162 (S.C. Can) and see *In re Mendelson-Luke-Ennis Galleries Limited (No. 2)*, (1963) 5 C.B.R. (n.s.) 134 (Ont. Registrar).

[17] See, for example, paragraph (c) ss. 1 of s. 62.

2.3.21 It is possible for a secured creditor to realize on a security under civil law only if one assumes that, on the bankruptcy of a debtor, a second estate is created in the trustee. There is good reason for assuming that this is the case. Indeed, such an assumption is necessary to explain certain features of the Act. All of the property of the bankrupt vests in his trustee, but the liability to pay the debts is duplicated; both the bankrupt and the trustee have the liability. By reason of the stay of proceedings imposed by the Act, no action on the debt may be taken against the bankrupt before his discharge. On the discharge of the bankrupt, his liability to pay his debts is released. The liability of the trustee to pay the debts of the bankrupt still remains to the extent of the property of the bankrupt which comes into his hands.

2.3.22 It is this theory of two estates that permits a rational explanation for the distribution of subsequently found assets among the creditors, after the discharge of the bankrupt. If the liability to the creditors was completely released, the creditors could have no legal claim in the newly discovered assets. Assuming that the Act was not intended to affect the rights and liabilities as between a creditor and a third party, the theory of the two estates can also be used to preserve the liability of a guarantor, which has been held to be extinguished on the discharge of the bankrupt where he is the principal debtor.

2.3.23 Section 24 provides for the appointment of an interim receiver. Nowhere in the Act is there any reference as to when the appointment shall terminate although this may occur on any of the following circumstances:

(a) when a receiving order is made in respect of the debtor;
(b) when the petition for a receiving order in respect of the debtor is dismissed;
(c) when a proposal in respect of the debtor is ratified by the Court;
(d) when the term of appointment fixed by the Court expires;
(e) when the order appointing the interim receiver is set aside, or
(f) when the interim receiver dies.

2.3.24 *Other Defects*: In the course of our review of the *Bankruptcy Act,* we found other similar defects. It would not be useful to refer to all of them here. Reference will occasionally be made to others later in the Report.

CONCLUSION

2.4.01 In this Part of the report, we first described how the present bankruptcy system functions in the context of our changing society and how the fundamental changes that have taken place have made much of our legislation obsolete. This should not be surprising as it was created and developed when social and commercial conditions were much different from those that now prevail. We then discussed how the administration and supervision of the bankruptcy process differs, in practice, from what it is in theory and how a number of major weaknesses in the administration mechanisms greatly reduce the efficiency of the system. Finally, we gave several examples of many serious technical and drafting deficiencies in the present *Bankruptcy Act*.

2.4.02 For all these reasons, and those outlined *supra* in 1.2.35 to 1.2.41, we have come to the conclusion that there is an overriding need for a new bankruptcy and insolvency statute that would provide for an integrated and comprehensive bankruptcy system, devised to suit the needs of our time. What the aims and objectives of such legislation should be are discussed *infra* in 3.0.01 et. seq.

2.4.03 With respect to the problems of the international bankruptcies discussed *supra* in 2.1.41 to 2.1.47, we confine ourselves to recommending that attempts be made to negotiate an international agreement on conflict rules with the United States and other countries that trade substantially with Canada, such as England, France and Japan.

Part III

Proposals for a New Act

INTRODUCTION

AIMS AND OBJECTIVES FOR A NEW BANKRUPTCY ACT

3.0.01 In this Part, proposals for reforms are made. Before this is done, it is essential to shortly refer to what we believe must be the aims and objectives of a comprehensive bankruptcy and insolvency system for Canada.

3.0.02 *The System must Promote Equity*: In the first place, it is always important to keep in mind that bankruptcy is a system whereby the creditors are compelled to adjust and reorganize their relations with the debtor and each other in regard to the property of the debtor.[1] From time to time, the bankruptcy process is extended or modified, so as to better serve economic and social ends. This cannot be done, however, without a price being paid. For every person or group who receives more or fares better, another person or group may receive less or fare not so well. Almost one hundred years ago, Chief Justice Waite of the Supreme Court of the United States said that bankruptcy is an example in which the general welfare of the community is achieved by mutual sacrifices of various groups in it.[2] It is important, therefore, that above all else, the bankruptcy system should be fair and equitable in the demands it makes and the settlements it imposes.

3.0.03 In every province, means are provided for the execution of judgments. These vary from province to province and, to the extent that specific statutory provisions are made to adjust the rights of competing creditors of an insolvent debtor, they may well be *ultra vires*. A bankruptcy act should provide a procedure for the collective execution against the assets of an insolvent debtor, which should be uniform, as a general rule, in every province, and be equally available to all creditors, without regard to the province in which they reside or in which the assets are situated.

3.0.04 The property of the debtor, under the collective execution process provided by a bankruptcy system, must be seized, preserved and distributed among

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[1] See Max RADIN, *The Nature of Bankruptcy*, (1940), 89 Pen. L. R. 1 at 9.
[2] *Canada Southern R.R.* v. *Gebbard* (1883) 109 U.S. 527 at 536.

all of the creditors. In achieving this, equity must be done among and for all creditors and their debtor. Creditors must be protected from over-reaching and grasping creditors as well as from fraudulent debtors. Assets that a debtor has given away or in any other way disposed of, with the effect of giving some creditors an unjustifiable preference over the others or, in any way, defeating the creditors generally, must be pursued and recovered. Moreover, the economic impact of bankruptcy should be diffused by spreading the losses fairly over as wide a group as possible; and no priorities in the order of distribution should be allowed, unless they are justified on solid grounds.

3.0.05 *The Over-riding Public Interest*: There is an over-riding public interest in the bankruptcy system. It is expressed on the levels of social and economic concern. In the first place, it is recognized that, of all the resources the country possesses, its human resources are the most valuable. In the second place, it is recognized that the growth of the country's economic productivity and institutions depends, to a large measure, on the successful resolution of conflicts stemming from the financial difficulties of its citizens. In addition, once it has been accepted that it is in the interest of the country to establish a fair and equitable system for the adjustment of the conflicts between a debtor and his creditors and to relieve and rehabilitate the over-burdened debtor, there is a public interest that the system be not abused.

3.0.06 *The System must be Extended to all Debtors*: In our society, where credit is so freely available, the bankruptcy process should be equally available, as a last resort solution to financial disaster, to all debtors whether in business or not. By the same token, no class of debtors should be immune from bankruptcy if they fail to make an arrangement with their creditors. This is not to say, however, that all debtors should always be treated the same. For example, in the case of the failure of a bank or railway, the national interest may require that a special opportunity be given to assist or reorganize the enterprise or that a different method of liquidation be used so as to minimize the impact of the failure upon the country.

3.0.07 *The Social Dimension of Bankruptcy*: From the social point of view, the fact that a citizen is over-burdened with debts or harassed by his creditors may be the source of much evil. Through his inability to solve his financial problems and support himself and his family, much hardship and unhappiness may result to him, his family and the country at large. "The tensions built up in harassed individuals and families frequently contribute to family breakdown, mental illness, crime and economic dependency."[3]

3.0.08 Bankruptcy is, today, the "escape door" to the harassed or over-burdened debtor. In the past, it has taken many other forms. We have seen, for example, how, in ancient times, a debtor would pledge and, perhaps later, sell his wife and children to escape the barbaric punishment that was the fate of those who could not pay their debts in full. In the Middle Ages, it was a common practice for such a debtor

[3] CANADA, *Report on Consumer Credit* of the Special Joint Committee of the Senate and the House of Commons on Consumer Credit and Cost of Living, Ottawa, Queen's Printer, 1967, p. 58, quoting from a brief presented on behalf of the *Family Bureau of Greater Winnipeg.*

to escape his creditors by becoming an outlaw or by fleeing the country. Whenever the right to bankruptcy as an "escape door" is restricted, or when it is too difficult to become bankrupt, there is a great danger that debtors will resort to crime and desert their families they can no longer support and their responsibilities they can no longer face.

3.0.09 There is also a great social waste in having a large class of harassed or over-burdened debtors and of undischarged bankrupts. One of the principal objectives of the new act should be to minimize this waste and to make the most of the human resources represented by this group of debtors. Speedy and effective measures to promote their social and economic rehabilitation are imperative. A debtor should be able, and should be encouraged, to make an arrangement with his creditors, when he has the ability to pay his debts in whole or in part. When the burden of debt becomes too great, a debtor should not be prevented from entering bankruptcy. Once in bankruptcy, a debtor should be encouraged, subject to appropriate safeguards, to become, as quickly as possible, a self-supporting and productive member of his community. Measures must also be designed to protect the discharged debtor from the pressure of creditors endeavouring to persuade him to undertake to pay his discharged debts, thereby defeating one of the primary purposes of the Act.

3.0.10 *The System must Facilitate the Rehabilitation of the Debtor*: Indeed, we believe that, in respect of the individual debtor, the principal objective of the bankruptcy system should be to rehabilitate him and give him an opportunity to make a fresh economic start in life. Whether the debtor is good or bad should not affect his right in this regard. All debtors should be encouraged to become self-supporting as quickly as possible and be protected from the harassment of their creditors. There should be no bar to a debtor seeking employment, retaining what he earns and providing for the care and security of himself and his dependents. Equity would, however, demand that, where a large amount of property is retained by a bankrupt by reason of the appropriate exemption statutes, his right to be released of his debts should not be absolute. Equity would also demand that, if a debtor, within a certain period of time after his bankruptcy, acquires great wealth, he should be called upon to share it with his creditors.

3.0.11 This approach would emphasize, as we think it should, the civil, as opposed to the quasi-criminal, character of the bankruptcy process. The fact that the debtor has committed an offence for which he would have an answer under relevant statutes should not deprive him of the opportunity to make a fresh economic start in life.

3.0.12 *The Credit and Economic System must be Protected*: On the economic level, it is important to preserve public confidence in the credit system of the country. "From the vantage point of borrowers and lenders, an important goal is continuity of credit facilities on reasonable terms for reasonably good risks."[4]

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[4] *Problems of Bankruptcy*, Report and Research Proposal of the Brookings Institution, Washington D.C., December, 1964, p. 13 (not published).

Without the means of protecting both debtors from harassment by their creditors and the credit extended by creditors, a loss of public confidence in the system could easily develop.

3.0.13 There is also a strong public interest in the economic recovery of an enterprise that has failed or is in danger of failing. Such an enterprise, provided it is economically viable, should be given all reasonable opportunities to be reorganized.

3.0.14 *The System must Promote Commercial Morality*: It is important, too, that commercial morality be encouraged and the public be protected by preventing the dishonest or incompetent bankrupt from a too early return to business. Those who have abused the confidence formerly entrusted to them or have been dishonest or reckless, or who have otherwise disregarded or flouted accepted standards of commercial morality, should be prevented from doing business on their own for some period of time. The bankruptcy system should make it as difficult as possible for those who have failed in business to renew the methods they formerly adopted to the detriment of the community. Nothing, however, should prevent the honest and competent debtor from re-entering the business community.

3.0.15 On the failure of a corporation, new elements must be considered. The corporate technique has undoubtedly contributed a great deal to the development of the modern industrial state. Though essential in our economic system, this technique should not be permitted to be used as a means of defeating the aims and objectives of a modern bankruptcy system. For example, a man who has been inexcusably imprudent, dishonest or guilty of a serious infraction to the accepted standards of commercial morality should be subject to the same sanctions and disabilities, whether he is acting in his personal capacity or as the officer or agent of a corporation.

3.0.16 *Caveat*: In the following chapters, we discuss how these aims and objectives could be achieved. Reference will be made only to the important mechanisms and procedures that, we believe, are required in order to have a bankruptcy and insolvency system adapted to the need of Canadians. Many minor amendments and additions to the present law will be contained in the Bill that we are currently drafting.

CHAPTER 1

MEASURES TO FACILITATE THE PAYMENT OF DEBTS

3.1.01 *Arrangements Generally:* Almost all consumer bankruptcies are no asset or nominal asset cases in which the creditors get nothing. Indeed, for all estates closed in Canada in 1968, the unsecured creditors, including those that are preferred, received a total dividend of something less than six cents on the dollar. This would indicate that bankruptcy proceedings are generally of little practical value as a means of collective execution[1].

3.1.02 For these reasons, it would seem to be, as a rule, to the advantage of all concerned that an insolvent debtor should voluntarily come to an arrangement with his creditors. On the one hand, the creditors who would normally receive almost nothing on bankruptcy, as shown above, should, in this way, receive something. The debtor, on the other hand, can avoid much of the stigma of bankruptcy and may more readily rehabilitate himself. As a result, the community may well be saved the hardship, loss and often serious dislocation that may follow from a failure or a series of failures. It is for these reasons that to reach out and to assist the overburdened debtor in his difficulties, at the earliest possible moment, is one of the most important functions of the bankruptcy system.

3.1.03 An arrangement under the *Bankruptcy Act* is different from a composition or extension agreement that a debtor may make with his creditors outside of the Act. If an arrangement, made under the Act, is accepted by a majority of creditors and ratified by the court, it binds all of the creditors, whether it is accepted by them or not. *Supra,* in 1.3.23, a brief outline is given of the procedure by which a debtor may make a proposal for an arrangement with his creditors.

3.1.04 Provisions permitting an insolvent debtor to make a proposal to his creditors are designed, among other purposes, to encourage a debtor to pay what he

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[1] In 1968, the no asset estates totalled 727, nominal assets estates, 417, and estates with assets over $500, 164, or respectively 56 per cent, 32 per cent and 12 percent of the 1,308 non-business bankruptcies reported in 1968. (From the records of the Office of the Superintendent of Bankruptcy.)

can on his debts over a period of time. If an arrangement is accepted, the debtor will, as a rule, be permitted to retain his property. This often gives him the opportunity to re-organize his affairs and, ultimately, to consolidate his financial position.

3.1.05 A debtor who makes an arrangement with his creditors should, as a rule, pay more to his creditors than they would receive on a bankruptcy. As an arrangement is more demanding, however, not all debtors will choose to try to make an arrangement with their creditors as an alternative to straight bankruptcy. For the small debtor not in business, it may be beyond his endurance to live in reduced circumstances for several years, which an arrangement may require. The debtor in business may have difficulty in obtaining credit and, generally, in carrying on his business by reason of the restrictions often resulting from an arrangement. A debtor may well consider that the risk and hardship involved in the making of an arrangement is greater than any advantage that may accrue to him.

3.1.06 There are a number of reasons, however, that may induce a debtor to make an arrangement with his creditors. For example, the debtor is, as a rule, able to retain assets that he would otherwise forfeit on bankruptcy. These assets have a greater value and economic potential in his hands than if they were to be liquidated for the benefit of his creditors. Moreover, a debtor does not, under an arrangement, suffer the incapacities that he would, under a bankruptcy. This is especially important if, as is recommended *infra,* in 3.2.091 et. seq., these incapacities should become more severe than they are now. It is also proposed to restrict the number of times that a debtor, during a given period, may obtain a release of his debts by way of bankruptcy. For that reason, a debtor may have no other alternative, but to make an arrangement with his creditors, to obtain a release from his debts. Moreover, the small debtor may welcome the opportunity to make an arrangement in order to receive, along the lines proposed *infra,* in 3.1.30 et. seq., the assistance and counselling that will help him to learn to live within his means. The reduced publicity, which should prevail in these cases, and the avoidance of the stigma of bankruptcy should also induce some debtors to seek to make arrangements with their creditors.

3.1.07 Whether or not a debtor succeeds in performing an arrangement, to a great extent, depends upon his character, pride, self-discipline and tenaciousness. For these reasons, arrangements cannot be forced upon insolvent debtors. It must be their free and voluntary choice. They should, however, be encouraged, as much as possible, to make arrangements with their creditors for the payment of their debts.

3.1.08 *Present Facilities For Making Arrangements:* The present *Bankruptcy Act* and other statutes provide a variety of facilities whereby a debtor may make a proposal for an arrangement with his creditors. Except as they relate to small debtors, there are no serious deficiencies in the provisions of the *Bankruptcy Act* relating to arrangements and, in general, it would appear that the legislation functions reasonably well. There are, however, two matters that deserve consideration. These are, firstly, the multiplicity of statutes that, at present, contain provisions relating to arrangements and, secondly, the desirability of providing a

procedure permitting a debtor to give notice of his intention to make an arrangement. The need to provide small debtors with facilities to make arrangements adapted to their needs and conditions is discussed *infra,* in 3.1.13 et. seq.

3.1.09 *An Integrated Scheme For Arrangements:* The procedures whereby an insolvent debtor may make a proposal for an arrangement with his creditors are now found in four statutes[2]. All of these procedures should be brought together and placed in the *Bankruptcy Act.* The new procedure should be as flexible as possible so as to permit the greatest variety of arrangements to suit as many situations as possible.

3.1.10 *Notice of Intention:* Too often a debtor does not make a proposal for an arrangement with his creditors until bankruptcy is imminent. As a result, there is often not enough time for the debtor and his advisers to carefully formulate the proposal. While a debtor may be criticized for delaying to make a proposal until the last moment, the legislation should not have the practical effect of forcing him to make a hasty proposal that may be ill-conceived. Neither should it have the effect of putting him in the position where he makes a proposal that is rejected but that might well have been accepted if only the debtor had had a reasonable opportunity to arrange the necessary financing, guarantees and other details.

3.1.11 In order to gain time so as to permit more careful consideration of all the problems and alternatives involved in making a proposal, a debtor, under the present Act, may persuade a friendly creditor to file a petition for a receiving order. This results in an automatic stay of all proceedings against the debtor by his own creditors. While to the advantage of the debtor, this practice is against the spirit, if not the letter of the law. To prevent this, and in recognition of the fact that it is, in most cases, in the interest of both the creditors and their debtor that a reasonable time be given to a debtor to prepare a proposal free from the pressure of his creditors, a debtor should be authorized to file a notice of his intention to present a proposal for an arrangement.

3.1.12 For a certain period of time after a notice of intention is filed, all proceedings against the debtor should be stayed. Creditors could, however, protect themselves and their interest in the property of the debtor by applying for the appointment of an interim receiver. So that the privilege to file a notice of intention would not be abused, the failure of the debtor to file a petition for a proposal within the time limit after the notice is given, would be regarded as *prima facie* evidence that the debtor has ceased to pay his debts generally as they mature. A petition for a receiving order based on this presumption could then be filed.

3.1.13 *Present Facilities For Small Debtors to Make Arrangements:* Many small debtors not in business need special facilities adapted to their needs and conditions. The opinion was expressed *supra,* in 2.1.13 to 2.1.20, that the plight of the

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[2]*Bankruptcy Act,* R.S.C. 1952, C. 14 as amended by 14-15 Eliz. II, Can. S. 1966-67, C.25 and C.32, ss. 27 to 38; *Winding-Up Act,* R.S.C. 1952, C. 296, ss. 65, 66; *Companies' Creditors Arrangement Act,* R.S.C. 1952, C. 54 as amended by 1-2 Eliz. II, Can. S. 1952-53, C.3; *Farmers' Creditors Arrangement Act,* R.S.C. 1952, C.111. For a brief outline of the procedures under each of these statutes, see *supra,* 1.3.23, 27, 28 and 29.

consumer or wage-earner debtor was one of the most important problems that must be faced in the field of bankruptcy today. New and more flexible and effective methods for the relief of the small debtor must be devised. Provisions, which have the practical effect of making it difficult for a small debtor to make an arrangement with his creditors, must be removed. For the purpose of the following paragraphs, the term "small debtor" will be used to refer to the class of debtors, the largest part of which are wage-earners, but which also includes all those who are not in business.

3.1.14 At present, the provisions of the *Bankruptcy Act* permitting a debtor to make an arrangement with his creditors are not well adapted to the situation of the small debtor. While there is no reason, in principle, why such a debtor could not make a proposal under Part III of the Act, in practice, the costs, and particularly the fees of a private trustee are beyond his means.

3.1.15 Part X of the present Act was enacted in 1966, in recognition of the special problems of the small debtor. This Part provides a simple and inexpensive scheme for the orderly payment of the debts of a debtor who is not in business.[3] The Part was limited, until recently, to debts less than $1,000. There are also other debts, particularly secured debts, that are excluded.

3.1.16 The chief merit of Part X is that, while an order is outstanding, no proceeding, as a rule, may be instituted against the debtor in respect of any debt to which the Part applies. One of the defects of Part X is that it only applies to the debtors residing in the provinces in which the provincial government concerned requests the Part to be proclaimed in force.[4] Until it is proclaimed in force in all provinces, all debtors in Canada do not have the same opportunities for their relief and rehabilitation. There are, in addition, no provisions for summary relief from unconscionable transactions, the valuation of deficiency claims, the cancellation and valuation of executory contracts or for bringing secured creditors within the provision of the Part. Finally, it would seem that creditors, covered by the Part, may petition for a receiving order against the debtor even if he is not in default.

3.1.17 The following statement of the Honourable Daniel R. Cowans, of the United States, poses the problem well not only in terms of the United States, but also of the Canadian circumstances:

> A number of debtors, wisely or otherwise, are not willing to concede defeat in their efforts to pay their obligations. Rather than take the easier way out, they claim they desire to devote future income to the payment of their debts even though, in the bankruptcy, they would be excused from doing so. Indeed, many who go through straight bankruptcy profess a most solemn intention to pay their debts in spite of their discharge. Actually, they seldom do so. Unquestionably in some cases the intention was not expressed in sincerity. In many other cases however, the failure is due to the lack of a sufficiently firm determination. In some of these and in still others there is a lack of sufficient knowledge of money management. No one familiar with debtor-creditor problems would deny that millions of persons do not understand financial matters well enough to live within their income. Some persons believe that such debtors should be made to suffer as an aid to learning. At the

[3] For a brief description of this Part, see *supra,* in 1.3.24 and 1.3.25.

[4] Part X has now been proclaimed in all provinces except Ontario, Quebec, Newfoundland and New Brunswick.

other extreme is the view that they must be let alone because the debtor's freedom from worry is a more important objective for society than the payment of debts.[5]

3.1.18 It should be recognized that many small debtors sincerely want to pay their debts in full and, if this cannot be done, they want to pay as much as they can as an alternative to bankruptcy. While debtors should be encouraged to pay their debts, for the reasons mentioned earlier, *supra* 3.1.06, they should not, however, be put in the position of being forced to pay them by being denied the right to voluntarily enter bankruptcy.

3.1.19 The path of the small debtor who wants to make a voluntary arrangement with his creditors must be made easier. He should be encouraged both to frame a feasible arrangement for his own circumstances and, then, carry it out to its completion. At the same time, the power of creditors to reject arrangements must be limited. Other obstacles placed by creditors in the way of a debtor wishing to make an arrangement should be removed. For the small debtor, the opportunity to make a fresh start through an arrangement is, for example, largely illusory if much of his property which he requires to maintain a minimum standard of living may be repossessed by his creditors.

3.1.20 The provisions now contained in the *Bankruptcy Act,* permitting a small debtor to make an arrangement with his creditors, should be extended. The system must be comprehensive, just and equitable to both debtors and creditors. We believe that there are, in this respect, two types of need for those not in business who wish to make an arrangement with their creditors. Firstly, there are those debtors who need only time to pay all of their debts in full. A procedure permitting them to make an extension agreement binding upon all their creditors should be available. Secondly, there is the need of those debtors who cannot pay their debts in full, but who do not want to go into bankruptcy. For these debtors, there should be available a simple and inexpensive procedure permitting them to make a composition with their creditors.

3.1.21 *Arrangements For Small Debtors by Way of an Extension:* For the reasons already mentioned, there should be a simple procedure largely modelled on the present Part X, whereby a small debtor could make an extension agreement with all of his creditors, whether secured or unsecured, except a mortgagee or vendor of immoveable property. Under our proposed procedure, any insolvent debtor, whose principal income is derived from wages, salary or commissions and who does not, on his own account, carry on business, would have the right to make an application for a consolidation order. An extension agreement or consolidation of debts would be made and be binding upon all creditors of the debtor, unless the amounts that the debtor can reasonably expect to pay are not sufficient to reimburse, within three years, all of his debts with interest calculated at the rate of 5%. This period of time is as long as one can reasonably expect most debtors and their families to accept the discipline of the financial restrictions imposed by an arrangement. A

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[5] Daniel R. COWANS, *Bankruptcy Law and Practice,* St. Paul, West Publishing Co., 1963, p. 83. Judge Cowans is a referee in Bankruptcy, Northern District of California and a Professor of Law, University of Santa Clara.

creditor would be permitted to object to the consolidation order in respect of the amount listed as being owed to him or another creditor, the amounts fixed for periodical payment by the debtor and the times of payment of such amounts. On the filing of a petition, all proceedings against the debtor would be stayed until the petition is either withdrawn or dismissed or, if a consolidation order is made, until it is subsequently set aside by the court. There would be no meeting of creditors, but any creditor, whether secured or unsecured, would have the right to apply to the court for the annulment of the order, provided he exercises it within thirty days after the date of the making of the order and he shows to the court that the order is not in the best interest of all the creditors or constitutes an abuse that amounts to fraud with respect to particular creditors. The annulment of the consolidation order would, in such a case, result in the automatic bankruptcy of the debtor.

3.1.22 Such a system would be fair and equitable and would have the merit of being both simple and inexpensive. It would be available only to a debtor who can be expected to pay all of his debts within three years. As a debtor would not be allowed to come under this plan unless it can be reasonably expected that he will fulfill his obligations, the creditors would normally fare better under a consolidation order than in a bankruptcy.

3.1.23 *Arrangements For Small Debtors by Way of Composition:* With respect to small debtors, we see the need for another scheme. The plan already described would be for the debtor who wants to pay his creditors in full and has the means and capacity to do so within a period not longer than three years. The other plan, which we now discuss and recommend, would be for the debtor who wants to pay his debts, but cannot reasonably be expected to be able to pay them in full within three years. This plan would differ from an extension agreement and present Part X, in that the debtor at the end of the plan would receive a release of the balance of his debts. However, the principal difference, between present Part X and the new scheme we recommend, is that there would be a positive approach to the rehabilitation of the debtor. This would compare to the approach taken by the court in respect of the rehabilitation of a person convicted of a crime through the facilities of the probation service. The small debtor who cannot pay or has not the desire or incentive to commit himself to an arrangement that may extend over many months could go into bankruptcy. Of the three alternatives, however, only bankruptcy could be forced on a debtor.

3.1.24 Under the plan, there would be an immediate stay of all proceedings against the debtor as soon as he proposes an arrangement. This stay would continue during the term of the arrangement. At the end of the term, which could not be longer than three years, the debtor would receive a release from the balance of his debts.

3.1.25 In the recommendations made for the plan permitting a debtor to make an arrangement by way of an extension, there is no provision for a meeting of creditors, as the debtor would be proposing to pay his creditors in full. In the case of an arrangement by way of a composition, we are of the opinion that a meeting of creditors should be called. The creditors would there have the opportunity of

learning, at first hand, the nature of the proposed arrangement and better able to assess the good faith and capacities of the debtor. The creditors would be in a position to weigh what they could expect to receive under the arrangement with what they would receive under an immediate bankruptcy. All creditors, except those whose claims are postponed, would then have the right to accept or reject the plan proposed. If a majority of the creditors at the meeting accept the plan, all creditors would be bound by it, including those whose claims are postponed. If a quorum is not present at the meeting, the arrangement would be deemed to have been accepted. The ratification of the court would not be required, but a creditor could, within ten days, apply to the court for an order annulling the arrangement where it is not in the best interest of all creditors or constitutes an abuse that amounts to fraud with respect to particular creditors. The annulment of the arrangement would, in such a case, result in the automatic bankruptcy of the debtor.

3.1.26 *Provisions Applicable to all Arrangements by Small Debtors:* The default of the small debtor would result in the summary setting aside of the arrangement and the creditors would then have the right to enforce their claim by any means available, including bankruptcy. There is a need, however, to provide for some flexibility in the operation of an arrangement by a small debtor. He may be faced with an emergency that prevents him from complying with the arrangement. For that reason, there should be a provision allowing the debtor, under certain conditions, to suspend his payments and to make up, after the term contemplated for the arrangement has expired, the payments he has missed. An attitude that would interpret the spirit of the plan as a contract to pay fixed periodic sums for a fixed term of time, without any provision for a variation in the plan where circumstances have changed, would defeat the aim of the plan.

3.1.27 We are of the opinion that there should be a real attempt, through an arrangement, to help the debtor to learn money management and to resist the many pressures that can lead to recurring financial difficulties and insecurity. In almost every community, there are agencies providing advice on the preparation of a family budget and financial guidance and counselling. It would be essential that every step be taken to ensure that debtors under a plan fully use these services. Because of the major role these agencies could have in the financial rehabilitation of the debtor, the government should be prepared to assist them and, where they do not exist, to provide the service directly to these small debtors.

3.1.28 Periodically, the debtor should be required to review the operation of his arrangement. To gain experience in the proper handling of money, he could, for example, be permitted to retain the payments payable under the arrangement and, under supervision, pay the dividends due to his creditors pursuant to the arrangement. In this way, it could be hoped that the debtor would acquire some experience in the management of money and, thereby, be able to, at least, recognize and avoid the circumstances that, in the future, could again lead him to financial disaster.

3.1.29 *Provisions Applicable to all Arrangements:* The difference between a debtor succeeding or failing in the making or the performance of an arrangement

may well depend upon whether or not the debtor has been the victim of a single harsh, onerous or unconscionable transaction. The debt incurred in, or the continuing burden of, a particular transaction may make it difficult for him to come to an arrangement with his other creditors and to perform it, if one is accepted. Creditors may also be reluctant to accept an arrangement, if another creditor is permitted to keep an advantage obtained by harsh and unconscionable conduct. In other cases, they may have doubt that the debtor can carry out the arrangement, if he must continue to assume the liability of an onerous lease or contract. It is, therefore, important that, for all debtors, in all types of arrangements, there be summary procedures to provide relief against harsh and unconscionable transactions and for the disclaimer of executory contracts or leases.

3.1.30 The contract, which may be too onerous to the debtor; may be a commercial contract required to be performed over a period of time. In the case of a manufacturer, for example, it may be that, through miscalculation, each unit is produced by him at a loss, making the operation unprofitable. To the wage-earner, this may be a contract to purchase food for a home freezer, in an excessive amount or price, over a period of time, or an agreement to take a long series of dance lessons. To a businessman, a lease may be too onerous, if the arrangement he proposes to make contemplates his closing down certain facilities and his reducing the scope of his operations, in order to do business at a profit. For the debtor not in business, it may be advisable for him to move from a luxurious to a more modest dwelling. In all these cases, the debtor should, with suitable safeguards, be permitted to disclaim the contract or lease, and we so recommend. If, however, the other party minimizes his loss, a claim for damages should be provable in the arrangement.

3.1.31 In all the provinces of Canada, there are Unconscionable Transactions Relief Acts that permit the courts to intervene and grant relief where the cost of a loan is excessive, harsh and unconscionable.[6] Although all the statutes are similar to each other, only a minority of them, however, apply to both vendor and lender credit transactions. Under all the statutes, the procedure to obtain relief is costly in time and money. For the purposes of an arrangement, the relief available may have little practical value, if the arrangement is completed, or well on the way to being completed, before final judgment is obtained. We accordingly recommend that there be a summary procedure that would permit the simple, speedy review of vendor and lender credit transactions, where the cost of the credit is excessive or the transaction is otherwise harsh and unconscionable.

3.1.32 *The Treatment of Secured Creditors:* We have referred, *supra* in 2.1.24 to 2.1.29, to the growth of secured financing, in recent decades, not only on the part of commercial debtors, but of consumers as well. We have also mentioned, *supra* in 2.1.06, the fact that used goods in the hands of a trustee, and, for that matter, in the hands of a secured creditor on repossession, have only a fraction of the value

[6] In all of the statutes, except Manitoba and Saskatchewan, the court can only intervene where "the cost of the loan is excessive *and* the transaction is harsh and unreasonable." See Ronald C.C. CUMING, *The Creditor's Remedies in Canada,* in *Aspects of Comparative Commercial Law*, McGill University, Montreal, p. 209 at p. 230. For the province of Quebec, see, in particular, sections 1040 (c) and 1040 (d) of the Civil Code.

they had while in the hands of the debtor. An important question that arises is what should be the position of secured creditors under the various plans for an arrangement proposed in this Report. The question also arises as to how these creditors should be treated when, at the time the arrangement is made, they have repossessed their security, but the debt has not been entirely paid.

3.1.33 Under the general plan for an arrangement, supra in 3.1.08 and 3.1.09, which, we expect, should continue, in practice, to apply mostly, if not only, to commercial debtors, the secured creditor would keep his right, under his contract, to repossess or liquidate his security, notwithstanding the filing of a petition for, or the making of, an arrangement by the debtor. However, unless the debtor is otherwise in default, the mere fact that a debtor has become insolvent or bankrupt or has filed a petition for an arrangement, should not permit the creditor to accelerate the payments under the contract or to repossess or liquidate the security, notwithstanding any provision contained in the contract or any statutory rule to the contrary. The provisions regarding the valuation of deficiency claims, which are described *infra* in 3.1.39, would, however, apply where the secured creditor exercises his right to repossess or has already exercised it, at the time of the filing of the petition for an arrangement.

3.1.34 Different considerations, however, arise in the case of arrangements by small debtors by way of extension or composition. Most small debtors, who find themselves in financial trouble, do not own, free from encumbrance, the property they need to maintain a decent standard of living. The car they need for work, their stove, refrigerator, furniture and often clothing, are being bought on time and are not owned outright, or else have been pledged as security for a loan to obtain relief from a previous financial crisis. Very often, it is the desperate effort of these debtors to keep up their payment on these secured debts that makes it impossible for them to pay any reasonable amount on their unsecured debts. When this occurs, the pressure put by the unsecured creditors upon the debtor is often more than the debtor can resist. As a result of a garnishee or a physical or mental breakdown, induced by the worry over his condition, he may lose his job. With the loss of his wages, he can no longer pay his secured creditors. When the creditors repossess their security, the situation of the debtor becomes still more desperate.

3.1.35 The legislative changes recommended *supra* in 3.1.33 should also apply in the case of arrangements by small debtors by way of extension or composition. Further restrictions should be imposed on the rights of a creditor having a security on a movable and on those of an unpaid vendor of movables, in the case of arrangements by small debtors. We believe that, under an extension arrangement, a creditor should not be permitted to exercise any right he may have under a security on a movable, unless the security was given during the sixty days prior to the filing of the petition for an arrangement and less than two-thirds of the amount owing has been paid. In order to provide for an adequate safeguard against abuses on the

part of debtors, in these circumstances, the secured creditor should be given the right to choose, within a certain delay, between filing a claim under the plan or maintaining his rights under the contract. These restrictions should not prove detrimental to these creditors as, under such an arrangement, all creditors are expected to be paid in full.

3.1.36 Still other considerations apply in the case of an arrangement by way of a composition by a small debtor as, under such an arrangement, the debtor does not contemplate paying his debts in full. In such circumstances, the secured creditor should be given the right to choose, within a certain delay, between filing a claim under the plan or maintaining his rights under the contract, in every case where the debtor has not already paid two-thirds of the amount owing.

3.1.37 The other question that remains to be discussed relates to the secured creditor who, before a petition for an arrangement has been filed, has already exercised his right to repossession, and is allowed to file a claim for the balance of his debt under the arrangement, as recommended *supra* in 3.1.33.

3.1.38 In these cases, the normal procedure would apply and, the credit grantor, where allowed under the relevant law, would have the right to seize the security, sell it and apply the proceeds of the realization against the balance of the debt. Under such procedure, any surplus is returned to the debtor, but, when the amount realized is insufficient to satisfy the debt, a claim may be made against the debtor for the deficiency between the amount owing and the proceeds of the realization of the security. When the re-sale of the security is not carried out with due care or the credit grantor is not diligent in obtaining the best price for the security seized, the deficiency claim against the debtor will be larger than what it should be. In many cases, the repossession and liquidation of the security result in a double loss to the debtor. He loses the property that is repossessed and he may stand to lose a good part of the loan or purchase price, if there is little realized on the re-sale.

3.1.39 To protect the debtor from the improvident foreclosure sale, we recommend that, in these cases, there be a summary procedure to adjust the value of the deficiency claim of a creditor to the amount it would have been, if the creditor had used reasonable diligence and prudence in the liquidation of the security.

3.1.40 Finally, in some cases, the debtor may have immovables that he should be allowed to keep in order to facilitate an arrangement with his creditors. To provide temporary relief, in these cases, we recommend that there should be a procedure permitting the temporary suspension of the principal payments on immovable property, any amount not paid during the period of the suspension, however, to be made up by the debtor, when the period of suspension is lifted.

3.1.41 *Moratorium:* The final recommendation that we make to assist insolvent debtors to satisfy their debts, other than by bankruptcy, is that the Governor in Council should have the authority to proclaim a moratorium for any specified region of the country or designated industry, whereby all proceedings against any debtor covered by the moratorium, unless otherwise permitted, would be stayed.

When there is a severe drought, earthquake, fire, crop failure or other act of God or some serious financial failure, disaster or set-back that may adversely affect an entire community or region, those affected by the disaster may well need an opportunity to adjust to it and reorganize their affairs. A moratorium staying, for a short period of time, all proceedings against those affected may well be sufficient for them to avoid more difficult financial problems as, they may, after the moratorium is lifted, be able to meet their liabilities as they become due and, in this way, avoid personal bankruptcy. Although the term of the moratorium should not exceed a few months, perhaps six months at the most, there should be some safeguard against possible abuse and hardship, for example, by permitting a creditor to apply to the court to have the moratorium lifted in respect of a particular debt, if the balance of convenience and hardship indicates that it is just to do so.[7]

3.1.42 *Bankruptcy:* Although it is desirable that all debtors should try to pay their due debts, without resorting to bankruptcy, there are some who cannot or will not pay their debts. For these debtors, there is a need for bankruptcy. In the following chapter, our recommendations, in this regard, will be discussed.

[7]A precedent for this kind of legislation is the "sursis extraordinaire" under the Swiss law. *"Loi fédérale sur la poursuite pour dettes et la faillite,"* April 11, 1889 art. 317(a) to 317(o). For a discussion fo the constitutionality of such a provision, see *supra* 1.4.26.

CHAPTER 2

THE LAST RESORT SOLUTION

3.2.001 When all else fails, bankruptcy is needed by both creditors and debtors. From the viewpoint of the creditors, bankruptcy provides a system of collective execution and equitable distribution of the assets of a failing debtor. On the other hand, to the debtor, bankruptcy represents the means of obtaining relief from an overwhelming burden of debt and the opportunity to make a new financial start in life.

I Conditions Precedent for Bankruptcy

3.2.002 *The Debtor*: Before a debtor, under the present Act, may voluntarily become bankrupt, his liabilities to his creditors provable as claims under the Act must amount to at least one thousand dollars.[1] This has been the law since 1949. Prior to that, the provable claims had to amount to at least five hundred dollars. Other countries have not the same concern with the amount of debt a debtor must have before voluntarily resorting to bankruptcy. In England, all a debtor must establish is that he "is unable to pay his debts".[2] The Australian Act is silent regarding the amount of debt owed by the debtor.[3] In the United States, a voluntary petition may be filed without any consideration of the amount owed.[4]

3.2.003 Before a debtor may be petitioned into bankruptcy, his debts owing to the petitioning creditor or creditors must amount to one thousand dollars or more. This compares with fifty pounds in England,[5] five hundred dollars in Australia[6] and one thousand dollars in the United States.[7] In France, only a debtor

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[1] Section 2(j), of the *Bankruptcy Act.*
[2] *Bankruptcy Act,* 4-5 Geo. V, 1914, U.K.S., C. 59, s. 6.
[3] *Bankruptcy Act 1966,* Austral. S., 1966, No. 33, s. 55, s. 56 and s. 57.
[4] 11 U.S.C., s. 4.
[5] Section 4(1).
[6] Section 44(1) (a).
[7] Section 4(b).

who is in business may be put into bankruptcy and no minimum amount of debt is required.[8]

3.2.004 Representations have been made that the minimum amount of debt a debtor must have before he may become bankrupt should be increased to two, three or five thousand dollars and that wage earners, or those who are not in business, should not be permitted to resort to bankruptcy. Both suggestions reflect a concern that some persons take an undue advantage of the *Bankruptcy Act* or that it should be more difficult for a wage earner to resort to bankruptcy.

3.2.005 Taken by itself, the amount of a person's debts is not particularly meaningful. It only becomes meaningful when the debts are compared with the person's assets. A person may, for example, have $1,000 of debts and assets worth $999 and be legally insolvent. It could be suggested that a person should not be forced into bankruptcy unless he had a deficit between his assets and liabilities of at least one thousand dollars. This would be difficult to ascertain as there could always be honest differences of opinion over the value of assets. It would, in addition, not take into consideration the case of the debtor who might have a surplus of his assets over his liabilities but, for lack of liquidity, could be quite unable to pay his debts as they fall due.

3.2.006 The time is past when bankruptcy was regarded as the privilege of only a certain class of debtors, such as merchants or traders. When credit is equally available to all, bankruptcy should be equally available to all debtors. The burden of debt is just as real and as great, if not greater, to the wage earner as the man in business. That a debtor should have a minimum amount of debt to voluntarily become bankrupt would discriminate against the small debtor. To increase the amount of debt required before a debtor could voluntarily become bankrupt, would be to further the discrimination. It would, at the same time, be somewhat absurd to have to say to the small debtor, who wanted the relief that bankruptcy could give, that he does not owe enough and to go away and incur additional debt before he could avail himself of the bankruptcy process.

3.2.007 It may be argued that, if a debtor cannot, or will not, pay his debts, bankruptcy, as a form of execution, should be available to a creditor no matter how much the debt may be. It was understandable, when bankruptcy was almost criminal in character and the penalties against a bankrupt were harsh, that the law would require a creditor to prove that the debtor owed to him a certain minimum debt before the debtor could be forced into bankruptcy. Now that many of the harshest sanctions against an insolvent debtor have been removed or ameliorated, bankruptcy is no more drastic than most other creditor rights. It is not unreasonable, however, as a condition precedent to a creditor choosing bankruptcy over any other method of execution, to continue to require him to have a substantial claim against the debtor. Such a condition has the effect of reducing the number of creditors who can, without joining others, initiate bankruptcy proceedings. This is especially the case with small debtors, as the number of their

[8] Law No. 67-563, July 13, 1967 and Decree No. 67-1120, December 22, 1967, *Règlement Judiciaire, Liquidation des Biens, Faillite Personnelle et Banqueroutes,* Art. 1.

creditors with a claim of $1,000 is generally much smaller than is the case of other debtors. This seems desirable, however, as no useful purpose could be served by allowing creditors with only small claims to force the small debtors in bankruptcy. On the other hand, it would not seem reasonable to increase the amount of claim a creditor must have before he may force a debtor into bankruptcy. This might mean, in some cases, that liquidation would be postponed while the debtor became further financially involved with less assets subsequently being available to the creditors.

3.2.008 For these reasons, there should be, in our opinion, no minimum amount of debt that a debtor must have to become voluntarily bankrupt. In the case of an involuntary bankruptcy, the amount of debt that must be owed to the petitioning creditor or creditors should remain at one thousand dollars.

3.2.009 Under the present Act, an individual engaged solely in fishing, farming or the tillage of the soil or who works for wages, salary, commission or hire at a rate of compensation not exceeding twenty-five hundred dollars per year and who does not, on his own account, carry on business, cannot be forced into bankruptcy, by reason of section 25 of the present Act. The protection that this section purports to give is, in fact, illusory. The property of these debtors that, by virtue of this section, cannot be seized through the bankruptcy process may be seized through other methods of execution. If, however, by provincial law, the property of these debtors is exempt from seizure, the same would apply in bankruptcy, as the property that is exempt from vesting in the trustee is the property that by provincial law is exempt from seizure.

3.2.010 An undischarged bankrupt is required, by the effect of section 157, to disclose the fact that he is an undischarged bankrupt whenever he seeks to obtain credit for a purpose other than necessaries of life. Creditors are prevented, by the effect of section 25, from forcing into bankruptcy farmers, fishermen, and the other persons mentioned therein. It follows that the obligation imposed by section 157 and the possible credit restrictions that its compliance would normally entail cannot be extended to these persons, unless they voluntarily file an assignment in bankruptcy. As a result, it may be argued that section 25 has been designed to protect, in this way, these persons.

3.2.011 In the new *Bankruptcy Act* that we are proposing, the provision equivalent to the present section 157 would apply only to debtors who have been dishonest or held responsible for their bankruptcy and to no others. As a result, farmers and fishermen with clean hands would enjoy the same protection as under the present Act, even if the creditors are permitted to exercise against them, as well as against the other debtors, the collective means of execution devised by the Bankruptcy Act. For this reason, there would be no justification, in the proposed Act, for a provision comparable to section 25.

3.2.012 *Who May Petition*? : Under the present *Bankruptcy Act*, only a creditor may petition the court for a receiving order against a debtor. This reflects a philosophy that bankruptcy is essentially a private matter between the creditors and their debtor. Very often, however, the creditors are unaware of the insolvency

of their debtor at an early stage. This results in lengthening the critical period, before bankruptcy, during which the assets of a debtor available for distribution among his creditors may decrease. "It is of the very essence of every wise and judicious bankrupt law, not only to provide for the fair, equal and speedy distribution of the estate of the insolvent, but to step in and arrest his downward course to ruin, so as to save for the creditors as much of the estate as possible . . . ."[9]

3.2.013 Often the creditor may not be the first to know that his debtor is insolvent. Frequently, the first to know that a debtor is in financial difficulties is a department or agency of government that exercises some regulatory or supervisory authority over the affairs of a debtor, such as a Department of Insurance or a Securities Commission. Where such a department or agency of government exercises such an authority, it is to protect the public from the possibility of fraud and to promote its confidence in the regulated enterprise. The public, however, may have a misconception of the role of these agencies and may be lulled into a false sense of security. Many people are, for example, under the impression that, if such a government department or agency has good grounds to believe that a regulated enterprise is insolvent or is about to become insolvent, it will petition for a bankruptcy order in respect of the enterprise. In a statement made in December of 1966, following the collapse of Prudential Finance Corporation, the Attorney-General of the Province of Ontario, the Honourable A.A. Wishart, questioned the adequacy of the *Bankruptcy Act* and the *Criminal Code* and suggested that the impact of the collapse might have been less severe, had the law been adequate. The criticism made by Mr. Wishart was to the effect that the *Bankruptcy Act* did not permit a government to take any action when it comes to its knowledge that a company may be in some financial difficulties, unless, of course, the government is a creditor.

3.2.014 For these reasons, we recommend that any agency or department of government, whether federal or provincial, that exercises a regulatory or supervisory authority over the financial affairs of a debtor, should be given the means of initiating bankruptcy proceedings whenever this would be necessary for the protection of the public interest. There are at least three precedents for such legislation.

The Canada Deposit Insurance Corporation Act,[10] for example, provides in section 29 that:

> (1) Where, in the opinion of the (Canada Deposit Insurance) corporation, a member institution is or is about to become insolvent, the corporation may, for the protection of the public interest, initiate and take any measures or proceedings that a creditor of the member institution may initiate or take under law to preserve the assets of the member institution, to have it wound-up or petition for a receiving order under the *Bankruptcy Act.*
>
> (2) For the purpose of this section, the corporation shall be deemed to be a creditor of a member institution notwithstanding that the deposit insurance in respect thereof has been cancelled.

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[9] Senator Robert H. HAYNE, of South Carolina, May 1, 1826, 2 (1), Cong. Deb. 656, 19th Cong., 1st Sess.

[10] 16-17 Eliz. II, C. 70, 1966-67.

Subsection 2 of section 161 of Part III (dealing with Insurance Companies) of the *Winding-Up Act* reads as follows:

> (2) When any company is deemed to be insolvent under the provisions of this Act, or of any other act of the Parliament of Canada, the Attorney-General of Canada, on the request of the Minister (of Finance), may apply to the court for an order that the company be wound up.

A further and recent precedent may be found in the *Bill for an Act Respecting Investment Companies.*[11] Subsection 1 of section 25 of this Bill provides that, under specific circumstances,

> . . .the Attorney-General for Canada may apply to a court of competent jurisdiction for a receiving order under the *Bankruptcy Act* and a receiving order may be made against such company as if it had committed an act of bankruptcy.

3.2.015 We also recommend that the Superintendent of Bankruptcy, for the reason outlined *infra*, 3.4.22, should have the power, in the limited circumstances there described, to initiate bankruptcy proceedings.

3.2.016 *Acts of Bankruptcy*: Traditionally, the conduct of the debtor, and not financial embarrassment, was the essential element of an involuntary bankruptcy. The status of bankruptcy commenced with an act by the debtor, such as flight from the country or a withdrawal from the market place. As bankruptcy was originally largely criminal or quasi-criminal in character, it was felt that a debtor should not be forced into bankruptcy, unless he had done something to merit such treatment. As one writer explained:

> The objective of the medieval law was to deal with the debtor who had done something that was legally culpable. Gradually the element of culpability became secondary and the mere fact that something, not necessarily culpable, had been done, that an act had been committed, became the essence of bankruptcy. The objective of the modern law is radically different. Instead of primarily dealing with the legal phenomenon involved in the debtor's *conduct*, it seeks to regulate the economic situation that arises out of the debtor's financial *condition.*[12]

More recently, Professor J.A. MacLachlan, who is regarded as one of the most prominent of modern scholars of bankruptcy in the United States, said:

> It has become increasingly apparent in modern times, however, that these so called acts (of bankruptcy) are merely statutory conditions precedent to the maintenance of an involuntary petition, and have no necessary relation to the metaphysical concept of an act done by the bankrupt or omitted by him in default of the discharge of some duty within his power to perform.[13]

"Acts of bankruptcy" are now recognized as "nothing but the reflexes of an insolvent man."[14] The failure to found bankruptcy upon the fact of insolvency rather than upon the commission of an act, has resulted in "a weakening of the bankruptcy law in relation to its important function of doing equity between creditors."[15] The necessity of having to prove an "act of bankruptcy" often delays bankruptcy until the debtor has become more deeply in debt, with the result that the creditors receive less.

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[11] Bill C-179, read for the first time in the House of Commons on January 19, 1970.

[12] Israel TREIMAN, *Acts of Bankruptcy: A Medieval Concept in Modern Bankruptcy Law* (1938), 52 Harv. L.R. 189 at 200. (The italics are those of the author.)

[13] J. A. MacLACHLAN, *Bankruptcy*, 1956, p. 42.

[14] G. GLENN, *The Diversities of the Preferential Transfer: A Study in Bankruptcy History*, 1930, 15 Corn. L.Q. 521, p. 530.

3.2.017 The inadequacy of a system based on "acts of bankruptcy" has long been apparent and attempts have been made to circumvent them. In England, "acts of bankruptcy" do not apply to corporations, which may be wound up if the corporation is "unable to pay its debts".[16] Moreover, a judgment creditor of an individual may, pursuant to the *Bankruptcy Act*, serve a notice upon the debtor to pay the amount owing in seven days. Failure to comply with the notice constitutes an "act of bankruptcy". This has the effect of almost dispensing with the use of other "acts of bankruptcy" by judgment creditors. In Canada, under the *Winding-Up Act*, there is no provision for "acts of bankruptcy"; a company is deemed insolvent "if it is unable to pay its debts as they become due."[17] This definition was used as a model for a new "act of bankruptcy", first introduced into the *Bankruptcy Act* in 1922,[18] which provided that "a debtor commits an act of bankruptcy . . . if he ceases to meet his liabilities generally as they become due." It has become the "act of bankruptcy" most frequently used by a petitioning creditor in Canada.

3.2.018 The traditional concern over the conduct of a debtor was not matched by a similar concern as to whether or not the debtor was insolvent. These concepts have evolved to such an extent that

> insolvency, using that term in the widest sense, is a primary consideration in determining who shall and who shall not be subjected to the peculiar effects of the bankruptcy process. Thus it has been frequently observed that our modern law of bankruptcy is essentially a law of insolvency.[19]

Indeed, the ultimate concern of a creditor is not so much whether the debtor is or is not insolvent from a balance sheet point of view, but whether or not the debtor has ceased to pay his debts generally as they mature. Various events or criteria should be available as tests or presumptions that the debtor has, in fact, ceased or is about to cease to pay his debts generally as they mature and that would make the debtor amenable to the bankruptcy process.

3.2.019 It is, for these reasons, recommended that a petitioning creditor should be entitled to a receiving order if he can show, in any manner, with or without the aid of the presumptions hereafter referred to, that the debtor has ceased to pay his debts generally as they mature. Certain events, such as the debtor making a general assignment of his property for the benefit of his creditors, should constitute a conclusive presumption that the debtor has, in fact, ceased to pay his debts generally as they mature.[20] Other events or facts, such as the debtor absconding without known provisions for the due and prompt payment of any of his debts, should be regarded as *prima facie* evidence that the debtor has ceased to pay

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[15] J.A. MacLACHLAN, *op. cit.*, p. 57.

[16] *Companies Act*, 1948, 11 & 12, Geo. VI, U.K.S., C. 38, ss. 22, 223.

[17] Section 3(a) *Winding-Up Act*, R.S.C. 1952, C. 296.

[18] *Bankruptcy Act Amendment Act*, 1922, 12-13 Geo. V., C. 8, s.3.

[19] SUTHERLAND, J., in *Continental Illinois Nat. Bank* v. *Chicago R. 1 & P. Ry.* (1935) 294 U.S. 648 at 668.

[20] This would be comparable to s. 3 of the *Winding-Up Act*, which provides that a company is deemed to be insolvent on the proof of a number of facts that includes the inability to pay its debts as they become due. S. 4, moreover, provides for a company being deemed unable to pay its debts as they become due, if the company fails to comply with what is equivalent to a bankruptcy notice.

his debts generally as they mature, thus throwing upon the debtor the burden of proving that he has not ceased paying his debts generally.

3.2.020 *Bankruptcy Notice*: *The Bankruptcy Acts* of England[21] and Australia[22] have a procedure for the service of a bankruptcy notice. A creditor, after having obtained a final judgment against a debtor, may serve on him a bankruptcy notice demanding payment of the debt. If the debtor does not, within a stipulated time limit after service, comply with the notice, he commits an "act of bankruptcy."

3.2.021 *The Winding-Up Act* has also a provision[23] similar to a bankruptcy notice. A company is deemed, under that Act, to be unable to pay its debts as they become due, whenever a creditor, to whom the company is indebted in a sum exceeding two hundred dollars or more, serves a demand requiring the company to pay the sum due and the company has, for ninety days, in the case of a bank, and, for sixty days, in all other cases, neglected to pay such sum or to secure or compound for the same to the satisfaction of the creditor.

3.2.022 In the 1962 Report of the Committee appointed to review the bankruptcy law of Australia, it was said:

> When, as is the case in Australia, a large number of bankruptcy notices are issued and relatively few become the basis of creditors' petitions, it is a reasonable inference that the service of bankruptcy notices on debtors has led to beneficial results to creditors, obviating further proceedings in bankruptcy. If, of course, a creditor used the procedure of a bankruptcy notice to obtain an unjust preference, (the fraudulent preference section of the Act) could be availed of, in the event of the debtor becoming a bankrupt, to set aside the preference. The service of a bankruptcy notice on a debtor also has advantages to the debtor. For example, it gives the debtor the opportunity of establishing that he does not owe the debt claimed by the creditor to be due to him or of proving that he has secured or compounded for the debt.[24]

3.2.023 A bankruptcy notice is intended to be not so much a procedure for the recovery of a debt, although it may have this effect, but a procedure whereby a conclusive presumption of insolvency is created to facilitate setting the machinery of bankruptcy into motion. We are of the opinion that, having regard to the fact that the greatest depreciation of a debtor's assets takes place in the critical period immediately prior to bankruptcy, it is highly desirable that bankruptcy should quickly follow where a debtor has ceased to pay his debts as they mature. The bankruptcy notice may serve a useful function in permitting a presumption of insolvency to be quickly established where the creditor has a judgment against the debtor. To a considerable degree, it is expected that the bankruptcy notice will replace the present "act of bankruptcy" whereby a sheriff makes a *nulla bona* return to a writ of execution, which, if our recommendations concerning "acts of bankruptcy" are accepted, would constitute a presumption that the debtor has ceased to pay his debts generally as they mature. The disadvantage in the use of the present "act of bankruptcy" in respect of a *nulla bona* return is that a busy sheriff may take a month or more before he can ascertain whether or not the debtor has property to satisfy the judgment and, if not, make a *nulla bona* return.

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[21] *Bankruptcy Act*, 4-5 Geo. V., U.K.S. 1914, C. 59, s. 2.
[22] *Bankruptcy Act 1966*, Aust. S. No. 33 of 1966, s. 41.
[23] Section 4.
[24] Para. 66, p. 23.

3.2.024 *Persons Abusing the "Corporate Veil"*: A primary purpose of the *Bankruptcy Act* is to prevent fraud and to encourage commercial morality. This can only be achieved if the debtor is subject to the control of the court. Where the debtor is a corporation, the corporate entity may have to be disregarded, so that the economic realities behind the legal facade may be taken into account in exercising control over those who acted on behalf of the corporation. In order to prevent a dishonest or incompetent debtor from returning to business, it will be recommended *infra*, in 3.2.097 that the incapacities of a bankrupt be increased and extended over a longer period of time. This could be largely ineffective in preventing fraud and promoting commercial morality, if the flesh and blood individuals who were responsible for corporate decisions cannot be reached, so that the incapacities imposed upon individual debtors could be imposed upon them. In England, the court may restrain those convicted of certain offences involving fraud from acting as directors or taking part in the management of companies for a period not exceeding five years.[25] We make a recommendation in this respect, *infra,* in 3.2.096.

3.2.025 When bankruptcy occurs, however, much damage may already have been done and the question arises as to whether some liability should not, in some circumstances, personally attach to the directors or officers of the bankrupt corporation. There are precedents for setting aside the corporate veil where it has been abused and creditors have suffered. The English *Companies Act*, for example, provides that if, in the course of the winding up of a company, it appears that any business of the company has been carried on with intent to defraud creditors or for any fraudulent purpose, the court may declare that persons who were knowingly parties to the fraud shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company.[26] The French *Code de Commerce* similarly provides that

> . . . peut être déclaré personnellement en règlement judiciare ou liquidation des biens tout dirigeant de droit ou de fait, apparent ou occulte, rémunéré ou non, qui a:
> - sous le couvert de la personne morale masquant ses agissements, fait des actes de commerce dans un intérêt personnel;
> - ou disposé des biens sociaux comme des siens propres;
> - ou poursuivi abusivement, dans son intérêt personnel, une exploitation déficitaire qui ne pouvait conduire qu'à la cessation des paiements de la personne morale.[27]

3.2.026 We recommend that, where a person carries on business through the means of a limited liability corporation that he, or persons related to him, control and, that becomes bankrupt, the court should have, in specific circumstances such as those described *infra* in 3.2.027, the power to order that person to pay to the estate in bankruptcy of the corporation an amount being the equivalent to the deficiency between the assets and liabilities of the corporation at the time of bankruptcy. Such person should, however, be allowed to limit his liability by proving that the loss suffered by the creditors and resulting from his misconduct was less than such deficiency.

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[25] *Companies Act*, 11-12 Geo. VI, U.K.S. 1948, C. 38, s. 188.
[26] Section 332.
[27] 1967, art. 101.

3.2.027 We believe that the recommendation contained in the preceding paragraph should apply where the person referred to therein,

(i) has made, in his own interest or in the interest of a person related to him, a transaction that cannot reasonnably be considered to have been entered into in the interest of the corporation;

(ii) mingled his own property with that of the corporation or dealt with the property of the corporation as if it were his own, or

(iii) was, in any way, responsible for the corporation conducting its business with a view to defrauding its creditors or for any other fraudulent purposes.

The recommendation should also apply where the corporation continued to do business resulting in some benefit or advantage to the person, or persons related to him, that controlled the corporation, when they knew or should have known that the corporation was insolvent and that there was no reasonable expectation that it would soon become solvent.

II The Effect of Bankruptcy on the Property of the Debtor

3.2.028 When bankruptcy occurs, the property of the debtor available for distribution among his creditors automatically vests in the trustee. It is then the responsibility of the trustee to identify this property, wherever and in whose possession it may be, and thereafter to take possession of it and protect it. The property is thereafter liquidated and the proceeds thereof distributed among the creditors in full settlement of their claims.

3.2.029 *Property that Vests:* Under the present Act, the property of a bankrupt that is exempt from execution or seizure under the laws of the province within which the property is situated and in which the bankrupt resides and the property that is held by the bankrupt in trust for another person do not vest in his estate in bankruptcy. Apart from these exceptions, all the property owned by the debtor, at the date of his bankruptcy, and all that acquired by him before his discharge is divisible among his creditors. A very wide definition of property is contained in the Act, which includes money, goods, land, property of any description and things in action.

3.2.030 The property of a debtor that is validly held by a secured creditor, either by way of a charge or by way of a conveyance subject to a right of redemption, does not vest in the trustee, but the equity of redemption does pass to the trustee.

3.2.031 *Exemptions*: As bankruptcy is a method of collective execution, to which is added a release of debts, it is only just and equitable that a bankrupt should not be able to withhold, from his creditors, property of any substantial value. A debtor may, however, obtain a release of his debts by way of an arrangement instead of through bankruptcy. If he is able to propose an arrangement that is acceptable to his creditors, it is not unreasonable that he should, in those circumstances, be entitled to retain his property. Indeed, the right of a debtor to retain his property, if he makes an arrangement, can be a strong incentive for him to make one. We are of the opinion that this is not an undesirable incentive as, in most cases, creditors will receive more through an arrangement than they would through the liquidation

of the property by way of bankruptcy. Moreover, to the extent that the amount of property that is exempt from vesting in a trustee is increased, this has the effect of decreasing a debtor's incentive to make an arrangement.

3.2.032 In this context, it is difficult to justify the present provisions of the *Bankruptcy Act* with respect to exemptions. As the exemptions are established by the provinces, they vary from one to the other. As a result, there is not, across Canada, a uniform law of bankruptcy with respect to the property that is available for distribution among the creditors of a bankrupt.

3.2.033 Exemption laws have been devised by the provinces in the exercise of their legislative powers to deal with matters coming within their jurisdiction. It should not necessarily be taken for granted that these exemption laws are equally appropriate in the context of bankruptcy. For example, to increase the amount of property of a debtor that is exempt from seizure has different implications depending on whether or not there is a bankruptcy. Outside of bankruptcy, the result could be that it will be more difficult for a creditor to execute upon his judgment. It may take longer for him to collect what is owed to him. He is not, however, required, in the end, to take less than what is owed to him. It is a different matter in bankruptcy. As the amount of the property of a debtor exempt from seizure is increased, there is a corresponding decrease in what is available for the creditors. The debtor will, as a rule, obtain a release of his debts irrespective of the amount his creditors have received. There comes a time when it is unjust, insofar as the creditors are concerned, to release the debts of a bankrupt without having regard to the amount of the property that he can retain. It would not be unreasonable, under these circumstances, to require a debtor to decide between keeping his exempt property and not obtaining a release of his debts or giving up some of his exempt property and obtaining a release of his debts.

3.2.034 Some bankruptcy statutes, such as those of England and Australia, contain a list of the property exempt from seizure. There is no constitutional reason why the same approach could not be taken in Canada. We are of the opinion, however, that it is preferable to leave to the provinces the responsibility for deciding what property should be exempt from seizure. In such a large country as Canada, the economies of the various regions may dictate different considerations for deciding what property should be exempt from seizure. However, the release of debts that a debtor receives in bankruptcy and the conditions under which it can be obtained are within the power of the Parliament of Canada to legislate, as they pertain to the subject matter of bankruptcy and insolvency. For these reasons, we recommend that all debtors should have the choice of retaining in bankruptcy all of their property that is exempt from seizure by the laws of the province in which they reside. A debtor, however, would only be entitled to a release of his debts, if the exempt property that is retained has a value not greater than, for example, $1,000, which would be increased by $300 for each of his dependents up to the maximum of $3,000. Such a scheme would provide for a variation, across the country, in the kind of property that is exempt. However, the value of exempt property that a bankrupt could keep, while at the same time obtaining a release from his debts, would be uniform across the country.

3.2.035 *Secured Creditors*: Under the present Act, the secured creditors do not come for most purposes within the provisions of the Act and their security does not vest in the trustee. They can, as a rule, proceed with the seizure and liquidation of their security in the same manner in which they could if there had not been a bankruptcy.

3.2.036 The position of secured creditors, under the various plans for an arrangement recommended in this Report, has been discussed *supra*, in 3.1.32 to 3.1.40. We do not believe that the rights of the secured creditors should vary depending on whether the debtor succeeds in making an arrangement or has been placed in bankruptcy. To give a privileged position to the secured creditor in the case of the bankruptcy of the debtor would, in many cases, constitute an invitation to the secured creditor to use all means available to him to defeat the attempts of the debtor to make an arrangement.

3.2.037 In the case of the bankruptcy of any debtor, we recommend a number of changes in the treatment of the secured creditor or an unpaid vendor. The first one relates to a clause that is frequently found in a variety of contracts whereby a debtor is deemed to be in default merely on becoming insolvent or bankrupt. We believe that, so long as the debtor has not defaulted in the payments due under the contract, the creditor or vendor should not be permitted to either have the remaining payments on the debt accelerated or to realize on the security or property, and we so recommend. If this recommendation were implemented, the debtor would be in a better position to effect an arrangement with his creditors or, this failing, the trustee would be in a better position to sell the business of the debtor as a going concern.

3.2.038 Secondly, a secured creditor should not be allowed, in any case, to repossess or realize his security, whether on movable or immovable property, without having first proven the validity and value of his security, and given the trustee the opportunity to attack the security, to redeem it, or to pay any arrears on the debt.

3.2.039 We finally recommend that, in all cases where there would have been repossession or realization of movable or immovable property, either before or after bankruptcy, the summary procedure recommended *supra* in 3.1.39, to adjust the value of any deficiency claim that may remain to the amount it would have been, if the creditor had used reasonable diligence and prudence in the liquidation of the security, should apply.

3.2.040 In the case of the bankruptcy of a "small debtor", we recommend that there be no other change in the treatment of creditors having a security on immovable property. However, we recommend that the creditor having a security on movables be prevented from realizing or repossessing the security where the debtor has paid two-thirds of the amount owing. If less than two-thirds of the amount owing is paid, the secured creditor should be given the right to choose, within a certain delay, between filing a claim in the bankruptcy or maintaining his rights under the contract. Where the creditor chooses to maintain his rights under the contract or in the cases where he has already exercised them before the

bankruptcy, his claim for any balance of the debt should be postponed until the claims of all other creditors are paid in full. In order for the system to be effective, these restrictions should also be imposed on the rights of an unpaid vendor of movables.

3.2.041 *Deemed Trusts*: Present section 39 excludes from a bankruptcy property held by the bankrupt in trust for any other person. This is done for obvious reasons as such property does not belong to the bankrupt and his creditors have no rights to share in it. Unfortunately, other legislation, both federal and provincial, has resorted to a legal fiction to aid governments to recover certain debts.[28] The *Canada Pension Plan,* for example, requires employers to hold back a portion of the salaries of their employees and to keep this amount separate and apart from their own property. In addition, subsections (3) and (4) of section 24 provide:

> (3) Where an employer has deducted an amount from the remuneration of an employee as or on account of any contribution required to be made by the employee but has not remitted such amount to the Receiver General of Canada, the employer shall keep such amount separate and apart from his own moneys and shall be deemed to hold the amount so deducted in trust for Her Majesty.
>
> (4) In the event of any liquidation, assignment or bankruptcy of an employer, an amount equal to the amount that by subsection (3) is deemed to be held in trust for Her Majesty shall be deemed to be separate from and form no part of the estate in liquidation, assignment or bankruptcy, whether or not that amount has in fact been kept separate and apart from the employer's own moneys or from the assets of the estate.

The effect of these provisions is to deem that the amount deducted is effectively held in trust for the government until it is handed over, whether or not the money so deducted is kept separate and apart by the employer. There cannot be much objection to this procedure whenever, at the time of the bankruptcy of the debtor, there is, in the estate, sufficient money to satisfy the claim of the government. The provision is thereby merely transforming a presumption of fact into a presumption of law. The legislation goes further, however, for in case of the bankruptcy of an employer, the law presumes that the money, which was supposed to have been set aside, but was not, was in fact kept separate and apart from the employer's own moneys, notwithstanding the fact the employer had no cash or money on deposit at the time of his bankruptcy.[29] In relying on this fiction, the government follows the easiest course of action. In this manner, it avoids having to exercise the necessary control to prevent an employer from mixing the moneys deducted with his own and taking action against him for his misappropriation. Thus, the law grants to government a privilege not available to other creditors whereby not only moneys, but all the assets of the employer, are, in case of bankruptcy, considered as held in trust for the government to the extent of the deductions.

[28] See, for example, *The Canadian Pension Plan,* (1964-65), 13-14 Eliz. II, C. 51, s. 24(3) & (4), and *The Provincial Income Tax Act,* (1964), R.S.Q., C. 69, s. 135.

[29] The following observation, although made in reference to the by-laws of a corporation, seems not to be inappropriate to the discussion of a "deemed trust", whereby the concept of a trust is changed into something altogether different. "To deem . . . that a thing happened when not only it is known that it did not happen, but it is positively known that precisely the opposite of it happened, is a conception to my mind if applied to a subject matter such as that of art. 93, amounts to a complete absurdity." *Robert Batcheller and Sons Ltd.* v. *Batcheller* (1945) Ch. 169 at 176 (1945) 1 All E.R. 522 at 530 per Romer J. One also recalls the words of Humpty Dumpty "when I use the word" he said in rather a scornful tone, "it means just what I choose it to mean—neither more nor less." *Through the Looking-Glass and what Alice in Wonderland Found There,* Lewis CAROLL.

3.2.042 This privilege invites abuses. It permits the employer, on the verge of bankruptcy, to use the moneys held back from his employees to pay his suppliers. He may feel free to act in this manner, not only because he is not under surveillance, but also because, within certain limits, he can do so with impunity. The case could, indeed, be made that in defending himself against a charge for misappropriation, he can invoke the legal fiction adopted by the legislator. If this whole theory is well-founded, the employer could only be accused of misappropriation of the assets held in trust in the case where, at the moment of bankruptcy, the total value of the assets was insufficient to cover the amount deducted. The employer is thus encouraged to finance himself, without cost, with the amount held back during the time granted to him to remit it to the government. In so doing, he may hope to avoid or postpone ultimate financial disaster. Unfortunately, last ditch attempts, in such circumstances, usually result in magnifying the proportions of the failure. In addition, the amount deemed to be held in trust amounts to a priority over the other creditors.

3.2.043 We are of the opinion that the use of deemed trusts to circumvent the scheme of distribution in the *Bankruptcy Act* should be avoided, where there is not, in the estate, at the time of the bankruptcy, sufficient money to satisfy the claim of the government for the money deducted.

3.2.044 *Statutory Charges*: The scheme of distribution has also been circumvented by provincial legislation making a department or agency of government a secured creditor for amounts owed to it. This would not be objectionable if the department or agency had to perfect their security under the laws applicable to other secured creditors. But this is not generally so. Moreover, the preference, given to the department or agency of government by this type of legislation, may further injure the other creditors who, not knowing of the outstanding security interest, may extend credit to the debtor. For these reasons, we recommend that governments should be subject to the same rules for the perfection of their security interests as are applicable to other creditors holding similar securities.

3.2.045 *Thirty Day Goods*: Under the law of the province of Quebec, an unpaid vendor of an article may revendicate it under four conditions: (1) the sale has not been made on credit; (2) the article sold is still entire and in the same condition; (3) the article has not passed into the hands of a third party who has paid for it, and (4) the right of revendication is exercised within thirty days after delivery.[30] In these special circumstances, it is only just and reasonable to recognize the equities of an unpaid vendor of merchandise over the rights of other creditors. We also believe that the law, in this regard, should be uniform in Canada. We, therefore, recommend that a provision similar to that contained in the *Civil Code* of Quebec, be added to the *Bankruptcy Act.*

3.2.046 *After-Acquired Property*: All of the property of a bankrupt that may be acquired by him or devolved upon him before his discharge is property divisible among his creditors. However, by virtue of section 67 of the Act, the after-acquired

[30] Articles 1998 and 1999 of the *Civil Code.*

property vests in the trustee in a qualified sense only. If the trustee intervenes and claims property, it vests in him indefeasibly. Failing the intervention of the trustee, the bankrupt is able to give good title by transferring his after-acquired property to a purchaser or transferee for value, except where the latter is aware that the transferor is a bankrupt.

3.2.047 The provisions for the vesting of after-acquired property have always been in the *Bankruptcy Act* and, as such, may be considered to be sanctified by tradition. It is questionable, however, whether the concept is valid in a modern bankruptcy system. Certainly, in practice, the value of the provisions is doubtful. All indications are that the percentage of after-acquired property realized in bankruptcy is negligible. As a matter of practice, only an individual will have after-acquired property, and this takes the form of either the sizeable part of his wages or, in the rare case, of property that he inherits. In situations where a bankrupt can foresee acquiring property of some value, the provisions may, in actual life, be easily circumvented. As all trustees do not show the same concern for after-acquired property, debtors are not treated the same throughout the country. In any event, when a trustee intervenes to claim the property, the cost of realizing after-acquired property is high. Perhaps the real purpose of the after-acquired property provisions is to punish the bankrupt. A bankrupt who has committed a bankruptcy offence may be denied an immediate and unconditional discharge. The threat of the possibility that a discharge may be refused and delayed and that, during that time, all his after-acquired property will be subject to seizure by the trustee, was no doubt considered to be a deterrent to a debtor tempted to commit a bankruptcy offence. We think, however, that it is ill advised to use the threat of refusing or postponing a discharge as a penalty or sanction against a bankrupt. The concept of seizing and distributing a debtor's property and releasing his debts should be kept separate from the incapacities attached to bankruptcy. We recommend, for instance, *infra* in 3.2.096 et seq., that certain bankrupts be prevented from returning to business for a certain period of time. At all times, however, bankrupts should be in a position to obtain gainful employment without the threat of the seizure of his after-acquired property. Otherwise, some debtors may choose to remain idle or to conceal, through various means, whatever property they may acquire.

3.2.048 For these reasons, we recommend that after-acquired property should not vest in the trustee, except in the case of property that a bankrupt acquires by inheritance within six months after bankruptcy; also, if a debtor within a certain period of time after his bankruptcy acquires great wealth, he should be called upon to share it with his creditors. These two exceptions are discussed in the following paragraphs.

3.2.049 *Property Acquired by Inheritance*: The first exception to the rule recommended above concerns property acquired by inheritance after bankruptcy. There is a similar exception in the United States *Bankruptcy Act.*[31] The reason for it is explained as follows by Professor J. A. MacLachlan:

[31] Section 70: "All property, wherever located, . . . which vests in the bankrupt within six months after bankruptcy by bequest, devise or inheritance shall vest in the trustee. . ."

> ...it offends common sense, if not common decency, to permit a debtor to go into bankruptcy as his wealthy ancestor reclines upon his deathbed, and procure a discharge from his debts after coming into wealth on the morn after petition in bankruptcy.[32]

3.2.050 *Bankrupt Becoming Prosperous:* The second exception to the rule that after-acquired property should not vest in the trustee concerns the case of the debtor who, within a period, such as three years or so after the date of his bankruptcy, acquires great wealth. In such circumstances, the court should be able to order the debtor to pay such moneys to, or consent to such judgment in favour of, the trustee, as it may direct. This proposed provision is not intended to interfere with the economic rehabilitation of the debtor. It is desirable that, as soon as possible, he should acquire steady and well paid employment and that he be in a position to support himself and his dependents in reasonable comfort. Nothing should be done to discourage a former bankrupt from accumulating savings and building up an estate. If, however, the debtor should, within three years or so after his bankruptcy, acquire great wealth, it is only just that he should share his good fortune with his creditors. In the United States, where after-acquired property does not vest in the trustee and there is no such provision as we here propose, the Act can, in isolated circumstances, be held in disrespect. The movie star may go bankrupt today and sign a lucrative contract tomorrow. A prize-fighter, on the eve of a championship bout, may similarly voluntarily become bankrupt to prevent his creditors from sharing his expected good fortune.[33] This kind of abuse would not be possible if our recommendation, in this regard, were implemented.

3.2.051 *Fraudulent Conveyances and Reviewable Transactions*: A debtor must be just to his creditors before he can rightfully be generous with his property for the benefit of others. For most of the common law jurisdictions of the world, this principle was first embodied in the *Fraudulent Conveyances Act* of 1571,[34] which declared that conveyances made with intent to defeat, hinder, delay or defraud creditors were "clearly and utterly void, frustrated and of no effect." Most, if not all, of the common law provinces have a *Fraudulent Conveyances Act* and an *Assignment and Preferences Act,* both of which relate to fraudulent conveyances. The *Civil Code* of Quebec also has provisions with respect to the avoidance of contracts and payments made in fraud of creditors.[35] Finally, sections 60, 61 and 62 of the *Bankruptcy Act* avoid certain settlements of property, if the settler subsequently becomes bankrupt.

3.2.052 The constitutionality of the provincial *Fraudulent Conveyances Acts* and *Fraudulent Preferences Act* has been discussed *supra* in 1.4.16 et seq. As trustees frequently rely upon the *Fraudulent Conveyances Acts* and the *Civil Code,* it would be unfortunate if they were deprived of the kind of remedy provided by this legislation.

3.2.053 In 1966, the *Bankruptcy Act* was amended by the addition of provisions allowing for the review of certain transactions involving, for example, related

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[32] J. A. MacLACHLAN, *op. cit.*, p. 179.

[33] The Primo Carnera case is an example. Twelve days before Carnera defeated Sharkey for the heavy weight championship, he voluntarily entered bankruptcy. *In re Carnera,* (1933), 6. F. Supp. 267 (S.D.N.Y.)

[34] 13 Eliz. I, 1571, U.K.S., C.5.

[35] Articles 1032 to 1040 C.C.

persons.[36] A similar technique is used in income tax matters. Through this technique, a transaction made between persons not dealing at arms' length, within twelve months prior to bankruptcy, may be reviewed. If, in the transaction, the debtor gave conspicuously more than he received, then judgment may be given for the difference. The onus is on the party who benefited from the transaction to show that it was fair. Section 678 also provides that, where a corporation, within twelve months of bankruptcy, has redeemed shares or granted a dividend, when the corporation was insolvent, or that rendered the corporation insolvent, recovery may be made against the directors or against certain shareholders of the bankrupt corporation. The onus is on the recipient to show that, immediately after the receipt of the benefit, the company was not insolvent.

3.2.054 The sections regarding reviewable transactions relate only to those transactions where the debtor and the creditor are not dealing with each other at arms' length. Admittedly, these are the situations where there is the greatest temptation for a debtor to be generous with his property. The provisions, by shifting the onus of proof, have been useful in controlling many situations where transactions were technically legal, but were commercially immoral. However, the field covered by the provincial *Fraudulent Conveyances Acts* or the *Civil Code* is wider than the one covered by the *Bankruptcy Act.* In our opinion, the *Bankruptcy Act* should cover the entire field of fraudulent conveyances, so as to make available, in the case of an estate administered under the *Bankruptcy Act,* the relief provided by the *Fraudulent Conveyances Acts* and Articles 1032-1040 of the *Civil Code,* and we so recommend.

3.2.055 *Fraudulent Preferences:* The payment by an insolvent person of a pre-existing debt is a preference. It is objectionable as it diminishes his assets to the detriment of his other creditors. The law against preferences prevents the race from being to the swift and promotes a more equitable distribution of the assets of the debtor. It, at the same time, makes it much less attractive for a creditor to negotiate preferential arrangements with insolvent debtors and indirectly encourages a higher level of commercial morality and greater confidence in the credit system.

3.2.056 The present law relating to preferences draws a line three months before the date of bankruptcy, in the normal case, or twelve months, where the parties are related, and creates an insulated period of time during which creditors cannot, by their efforts at collecting, through the use of pressure or otherwise, secure an advantage over the other creditors. In effect, the race by the creditors for the assets of the debtor is stopped three months or twelve months, as the case may be, before bankruptcy. The creditors who receive more than their share in the three or twelve month period are required to surrender it.

3.2.057 Useful as the provisions are, they have led to much litigation. The most troublesome feature is the necessity to show the intent of the debtor to give a

[36]Section 67A, *Bankruptcy Act,* R.S.C. 1952, C.14; as amended by 14-15 Eliz. II, Can. S., 1966-67, C. 25 and 32.

preference. In some provinces, the courts have held that the intent of the creditor to receive a preference must also be established. This is known as the requirement of a "double intent". In 1949, an attempt was made to remove from the Act the necessity of determining the intent of the debtor or creditor.[37] This would have greatly facilitated the use of the provisions. Unfortunately, the proposed amendment was not contained in the final draft of the Bill for the 1949 Act. The result has been twenty more years of litigation.

3.2.058 The law of preferences was developed before methods of financing through the security of inventory and receivables were widely used. The present law, now, defeats the purposes of legislation such as the new Ontario *Personal Property Security Act,*[38] which is based upon Article 9 of the *Uniform Commercial Code*[39] of the United States. Under this type of legislation, a security may attach to a shifting quantity and quality of property sometimes described as a "moving stream". New goods may be substituted for old goods. Goods may change as they are processed or manufactured into different goods. These, in turn, may be converted into receivables. The scheme of the legislation is that the proceeds from the inventory of the debtor and the replacement inventory come under the umbrella of a floating charge. As soon as inventory is sold and converted into receivables or new inventory is acquired, the security interest attaches to the receivables and inventory. When the security interest attaches to new property, there is necessarily a pre-existing debt. For this reason, the inclusion of new property in the security in this manner is a preference, and, if it has occurred within three months of bankruptcy, it could be set aside as fraudulent.

3.2.059 Section 88 of the *Bank Act,* whereby a floating charge over inventory and receivables may be created, presents a similar difficulty. However, section 169 of the *Bankruptcy Act,* which exempts the rights and privileges conferred on banks from the operation of the *Bankruptcy Act*, prevents property vesting in banks within the suspect period prior to bankruptcy from being set aside as a fraudulent preference. In our view, there is no logical or commercial reason why the law in this respect should be different in the case of a bank and all other creditors.

3.2.060 In our opinion, the law of preferences, as it is contained in the *Bankruptcy Act*, is basically sound and it has the same over-riding importance that it has always had in the bankruptcy system and the commercial community. We recommend, however, that it should be modified so as to provide a more comprehensive and equitable system. When a preference is given within the suspect period, intention should be irrelevant. No creditor should, for any reason, improve his position, at the expense of the other creditors, within the suspect period immediately prior to bankruptcy. The proof of the intent to give a preference should, however, be sufficient to impeach the preference given outside the suspect period. Furthermore, the law of preferences should, in our view, apply equally to banks and other creditors; it should, however, be such as to protect securities given

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[37] See *supra,* 2.3.06, where a description of the then proposed legislation is given.
[38] 15-16 Eliz. II, Ont. S., 1967, C. 73. (Not yet proclaimed in force.)
[39] *Uniform Commercial Code,* Master Edition, St. Paul West Publishing Co., 1968, vol. 3.

under Section 88 of the *Bank Act* and new Personal Security Legislation, so that the intent and purposes of such legislation would not be defeated.

3.2.061 *Preservation of Voidable Interests*: Where there are junior secured creditors, no benefit may accrue to an estate by avoiding a prior preferential security. As the law now stands, the avoidance of a preferential senior security redounds, not to the benefit of the estate, but to the benefit of the junior secured creditors. We recommend that, where a security is held to be preferential, the court could order that the security be assigned to the estate instead of avoiding it. If our recommendation were implemented, the junior creditors would not be prejudiced as they would be in exactly the same position as they were before the senior security was attacked.

3.2.062 *Deficiency in a Trust Account or Depository*: Where a debtor, who is a trustee, deposits, in a single account or depository, funds or property held by him under different trusts and subsequently wrongfully withdraws or dissipates a part of the property, an expensive and time-consuming investigation on the part of the trustee of the debtor's estate in bankruptcy is required to establish the rights of the various claimants. The estate itself may be a claimant, if the debtor has intermingled his own property with the trust property. Various rules have been developed to ascertain the deposits against which the wrongful withdrawals should be charged. There is, for example, the "first in-first out" rule established in the *Clayton's Case.*[40] There is also the rule of *Knatchbull v. Hallet*[41], which holds that where a wrongdoer mingles his own funds in a bank account with those of another person and thereafter makes withdrawals from that account, the wrongdoer is presumed to have first withdrawn his own funds. In practice, there is no way to ascertain with certainty which rule should apply without resorting to litigation. In the interests of certainty and in order to reduce the costs of administration, we are of the opinion that, when bankruptcy occurs, there should be a statutory rule governing the case where there is a deficiency in any depository held by a debtor. We recommend that, in such a case, the property in the depository, regardless of the order in which the property was deposited, shall, in case of bankruptcy of the debtor, be distributed, first, to his trustee in bankruptcy, to the extent that any deposits made by the debtor are voidable as against the trustee, and, thereafter, to all depositors on a pro rata basis. Any claim of the estate against the depository should, however, be reduced by the amount of the deficiency in the depository.

III Proofs of Claim

3.2.063 Although the provisions of the Act relating to proofs of claim need to be improved in many minor respects, it is sufficient to discuss here the need for a summary procedure for the liquidation of contingent claims.

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[40] *Devaynes* v. *Nobel,* (1816) 1 Mer. 572.
[41] *In re Hallets Case,* (1879) 13 Ch. Div. 696.

3.2.064 *Contingent Claims*: Under the present Act, all debts and liabilities, present or future, to which a bankrupt is subject at the date of the bankruptcy or to which he may become subject before the date of the bankruptcy may be proved in the bankruptcy. A contingent or unliquidated claim may also be proved if it is previously valued by the court. If the court refuses to value the claim, the holder of the claim may not prove it in the bankruptcy. As it cannot be proved, it is not released on the discharge of the bankrupt. Through no fault of the bankrupt, what could be the single largest claim against him may not be released. On his discharge, he will not be able to satisfy it and may be forced to go into bankruptcy a second time to obtain the release of a claim to which he was subject at the date of his first bankruptcy. There would, of course, be no problem if the court would always value a contingent or unliquidated claim. However, in many cases, the courts have refused to summarily value these claims. Judges have said that it was difficult to value the claims with any degree of certainty short of a full trial where all the evidence available in respect to both liability and damages was adduced. While respectful of the position taken by the courts in this matter, we are of the opinion that it does not sufficiently regard the relative positions of the claimant and the bankrupt. If the claim is not valued, the debtor is faced with what might be an impossible burden of debt after his bankruptcy. On the other hand, as a practical matter, there would be relatively little difference to the amount of the dividend a creditor receives for his injuries or damages arising out of a contingent or unliquidated claim, if the claim was not valued with complete exactitude, having regard to the fact that the dividend, on the average, would be about four cents on the dollar. Thus, the dividend the creditor would receive, if the claim was valued at $20,000, would be $800 and if, it was valued at $15,000, it would be $600. The difference of $200 on the dividend that could be available to the creditor, in such a case, should not stand in the way of the possibility that a debtor may be discharged with an unreleased debt of $15,000 or $20,000. Judges are often called upon to make similar valuations where there is often little evidence and a wide discretion, such as the valuation for pain and suffering or the amount of maintenance to be paid to support a wife or child. J.A. MacLachlan, in discussing the problem of the valuation of contingent claims, has said:

> Modern developments have facilitated the fair estimation of claims. Actuarial and analogous statistical data have been accumulated in various fields and the development of the casualty and surety business has been helpful. If the problem be approached with the basic principle in mind that an approximate valuation is much better than none, a reasonable value of some contingencies may be found in terms of the cost of insuring against them . . .[42]

It is therefore our recommendation that all contingent or unliquidated claims, to which a bankrupt is subject at the date of his bankruptcy, should be provable claims and that, in all cases, the court should be required to summarily value the same.

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[42] J.A. MacLACHLAN, *op. cit.*, p. 130.

IV Distribution of Realized Assets

3.2.065 It is often said that a fundamental purpose of bankruptcy is the equal distribution of the property of a debtor among his creditors. In fact, all creditors are not treated the same. Not less than ten classes of claimants are given a statutory priority to payment of dividends. However, all creditors, within the same class, are treated alike.

3.2.066 There are many reasons for the failure of the bankruptcy system to save a fair share of the assets of an insolvent debtor for the ordinary unsecured creditors. We have alluded to some of them *supra* in 2.2.07 and 2.2.08. Perhaps the most visible of these reasons is that too many classes of creditors are paid in priority to others.

3.2.067 In our opinion, the priority on distribution given to several classes of creditors cannot be justified. In some cases, the present priority should be abolished. In other cases, it should be modified. This will result in a more equitable distribution of the property of an insolvent debtor among his creditors. Moreover, although the overall increase in dividends to the ordinary creditors might not be great, this should promote greater confidence in the entire bankruptcy system and result in an increased interest of creditors in the administration of estates. It may also discourage expensive litigation, occasionally resorted to at the instance of the ordinary creditors who have little, if anything, to lose and all to gain, while the cost, in effect, is being borne by priority creditors. In the following paragraphs, we discuss whether each of the priorities under the present Act is justified.

3.2.068 *Funeral and Testamentary Expenses*: Payable as a first priority are the reasonable funeral and testamentary expenses incurred by the legal personal representative of the deceased bankrupt. The reference to "a deceased bankrupt" can only be to a debtor who has died after he became bankrupt. It cannot refer to a debtor whose estate becomes bankrupt after his death, as the estate cannot be referred to as a "deceased bankrupt". This creates the anomalous result that a claim for funeral expenses, which existed as of the date of bankruptcy of an insolvent estate, is not given a priority, while a claim for funeral expenses, which was not even in existence at the date of the bankruptcy of the debtor, ranks as a first priority. Furthermore, this is a strange result since such a claim, having necessarily occurred after the bankruptcy, is not "provable in bankruptcy" and, for that reason, should not normally qualify for a dividend.

3.2.069 If a debtor who is not a bankrupt dies and his estate is subsequently put into bankruptcy, there is no reason why the funeral director should not equally share the available assets with other creditors including the nurse, the physician and others who attended to him prior to his death. Similarly, under a system where a bankrupt is permitted to retain his after-acquired property, there is no reason why the creditors, at the date of the bankruptcy, should be asked to take less, in order to permit a creditor whose claim arose after the date of bankruptcy, whether it be for funeral expenses or otherwise, to share in the distribution of the property of the debtor available at the date of bankruptcy. Perhaps some may argue that to abolish

the priority for funeral expenses will make it more difficult to arrange for the burial of an insolvent or a bankrupt who may then have to be buried in a paupers' grave or at public expense. At worse, however, this would be no different from the many other cases of debtors dying insolvent. Moreover, if the deceased was a bankrupt, he could have, on his death, a small estate consisting of the property that he accumulated after his bankruptcy. This estate could be used to pay the funeral expenses. On balance, we have come to the conclusion that the priority given for funeral and testamentary expenses should be abolished.

3.2.070 *Costs of Administration*: The costs of administration, including the expenses and fees of the trustee and legal costs, are the second priority for payment of dividends under the present Act. In our opinion, it is only appropriate that these costs should be paid, and continue to be paid, in priority to all other costs.

3.2.071 *The Superintendent's Levy*: The third priority is the levy payable to the Superintendent of Bankruptcy to defray the expenses of his administration and supervision. At present, the levy varies, from two per cent of the first million dollars paid by the trustee for any purpose other than costs, to one-tenth of one per cent of the amount in excess of two million dollars. Some may argue that the cost of administering a public statute, such as the *Bankruptcy Act,* should be borne by the tax-paying public at large. In a large measure, the levy may, however, be considered as a payment to the Superintendent for his part in the administration of an estate. The point may well be made then that the government is, in effect, stepping in to fill the vacuum resulting from the creditors no longer taking any real and continuing interest in the control of the administration of bankruptcy estates. On balance, we have come to the conclusion that the levy should continue to be paid immediately after the other costs of administration, in priority to the other creditors.

3.2.072 *Wages*: The fourth priority concerns claims for wages, salaries, commissions or compensation of any clerk, servant, travelling salesman, labourer or workman, for services rendered during three months next preceding the bankruptcy, to the extent of five hundred dollars. It has been said that the purpose of the priority was "to favour those who could not be expected to know anything of the credit of their employer".[43] The three month period does seem to be ample time as the employee knows that he is not being paid and "should not mislead creditors indefinitely by working at their expense, when the bankrupt becomes such 'slow pay' as to indicate that he is failing."[44] In our opinion, it is reasonable to restrict the period to three months, but we recommend that the dollar amount be increased to one thousand dollars, to take into account the decreased value of the dollar.

3.2.073 *Municipal Taxes:* The fifth priority relates to municipal taxes owing by the bankrupt, where such taxes are not secured by real property, but only to the extent of the bankrupt's interest in the properties in respect of which the taxes

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[43] *In re Lawsam Elec. Co.*, (1924) 300 F. 736 (S.D.N.Y.) per Learned Hand, J.
[44] J. A. MacLACHLAN, *op. cit.*, p. 148.

were imposed. We see no reason why a municipality should be treated differently from any other creditor. A municipality has the means to protect itself in the same way as do other creditors and it should not be in the position to, in effect, require the creditors of a bankrupt taxpayer to pay the taxes that the taxpayer did not pay. For these reasons, we recommend that the priority for municipal taxes be abolished.

3.2.074 *Landlord's Claim for Rent*: The landlord's claim for arrears of rent, for a period of three months next preceding the bankruptcy, and accelerated rent, for a period not exceeding three months after the bankruptcy if entitled thereto under the lease, constitutes the sixth priority. The total amount so payable is not, however, to exceed the realization from the property on the premises under the lease. It is not obvious why a landlord is permitted to hold back taking proceedings against a failing tenant and then be permitted to recoup himself at the expense of the other creditors. It might be said, however, that it is in the interest of a debtor, who has some hope of rehabilitating himself short of bankruptcy, that his landlord should not take proceedings to terminate the lease at the first opportunity. On balance, we are of the opinion that a good case can be made for retaining the priority of the landlord for three months rent in arrears next preceding the bankruptcy, but the priority for three months accelerated rent cannot be justified and we recommend that it be abolished.

3.2.075 *Crown Priority*: The last priority, but the priority under which the largest amounts are paid, is that of the Crown. The history of the Crown priority goes back a long time. In *Magna Carta,* it was said that: "The King's debtor dying, the King shall be first paid".[45] At common law, the Crown had a prerogative right to be paid first. The Crown continued to assert its prerogative after the enactment of the first Bankruptcy Acts, on the ground that a statute could not bind the Crown. Eventually, the application of the *Bankruptcy Act* was extended to the Crown, but it continued to assert the necessity of a priority in its favour, on the ground that the Crown was invariably, certainly in respect of taxes, an unwilling creditor and could not choose its debtor. For these reasons, it was in the public interest and necessary for the protection of the public treasury that it be paid first.

3.2.076 It is, we believe, important to re-examine the public policy in respect of the Crown priority. It must be determined whether such a priority is justified in a modern society. Certainly, it is not necessary for the financial stability of the government.[46] The argument that the Crown cannot choose its own debtor has some relevance in claims for taxes, but none, as regards contractual claims. In this respect, it should be pointed out that individuals claiming damages do not choose

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[45] *Magna Carta* (Confirmed version), 9 Henr. III, 1225, 3 C. 18.

[46] To measure the loss of revenue to the government due to the abolition of the Crown priority in a given year, it would be necessary to ascertain the total dividends paid to the government in that year and then deduct from this the sum it would have received as an ordinary creditor. One would, however, have to take into account the fact that due to a smaller loss, the other creditors would have to pay a higher income tax. Lastly, one must consider the possibility that the elimination of the priority would improve bankruptcy administration by increasing the chances of a better dividend for the ordinary creditors and by encouraging them to better look after their own interests.

their debtors either; and yet, they do not benefit by a priority of rank. One wonders whether, in our economy of easy credit, the businessman has always the economic freedom to choose his debtor or whether he is not bound, to a certain point, to give credit to the same extent as do his closest competitors. It could even be argued that the government should rank after ordinary creditors, as the public treasury is, in fact, in a better position than anyone to bear the inevitable losses. The government can, in effect, divide the burden of tax left unpaid by the bankrupt among all the tax paying public. It would be more logical for the government to do this, than to take advantage of the bankruptcy of an insolvent taxpayer to reimburse itself, at the expense of the creditors who have already suffered losses. Certainly, there can be no rational explanation for the government to attempt to obtain payment of the tax due by a bankrupt from his creditors. Such a proposition offends one's sense of natural justice.

3.2.077 Whatever the logic or lack of logic there is in the priority of the Crown, the cumulative impact of the priority has substantially increased since the Second World War. Crown priorities have grown in three dimensions: (1) the rates of existing or old taxes have been increased; (2) there have been many new kinds of taxes; and (3) the Crown has become extensively engaged in business, particularly through the use of Crown corporations to which the Crown priority has been held, in many cases, to apply.[47] The apathy of creditors to take part in the administration of an estate in bankruptcy can very well be explained by reason of the Crown priorty. Very often, for the creditors to involve themselves in the administration of estates is equivalent to their volunteering as agents of the public treasury.

3.2.078 Professor J. A. MacLachlan, in his usual forthright manner and perhaps with some exaggeration, very harshly criticized the priority of the Government of the United States under its *Bankruptcy Act,* in these words:

> The unprecedented multiplicity and magnitude of tax claims is greatly aggravated by their priority . . . They strike the commercial community where it is weak by further impairing the financial condition of creditors who have had the misfortune of extending credit to a bankrupt. Unless governments can stop proliferating taxes to lavish largesse on politically favoured groups and to give public credit to those unworthy of private credit, bankruptcy may become just another device for paying official salaries. Dividends of priority creditors and to general creditors in bankruptcy have been less than 5¢ per capita per annum in relation to the national population, so the revenue at stake is chicken feed, but the commercial repercussions of accentuating bankruptcy frustrations may be disapro-portionate.[48]

3.2.079 In our opinion, the priority of the Crown in our modern society cannot be justified and we recommend that it be abolished.

3.2.080 *Postponement of Certain Claims:* We point out *supra,* in 2.1.12, that, as there are good and bad debtors, so there are good and bad creditors. "Equality is equity" is a concept as old as bankrupty, the same as its corollary that creditors, as a rule, should be paid *pari passu.* The discussion in the preceding paragraphs, however, serves to demonstrate that the law prefers some creditors to others. But,

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[47] *In re Spartan Air Services Limited* (1960)1 C.B.R. (N.S.) 33 (Ont. Registrar).
[48] J. A. MacLACHLAN, *op. cit.,* p. 284.

from the general body of ordinary creditors who would normally rank together *pari passu,* the law identifies certain creditors the payment of whose claims is postponed until the claims of all other creditors have been satisfied. Such is the case, for example, of the claim of a creditor who, prior to bankruptcy, has entered with the debtor into an improper transaction otherwise than at arm's length.[49] There are other cases, not now mentioned in the Act, that, in our opinion, deserve the same treatment. Such is the case, for example, of the claim of a creditor resulting from the operation of a penal clause under a contract, where no damages have in fact been proven. The same treatment should be given to a claim in respect of which a wilfully false statement or a wilful misrepresentation has been made to the trustee or to the court. Similarly, the same rule should apply to claims with respect to which a voidable preference was given, unless the preference was disclosed to the trustee not more than two weeks after the creditor became aware of the bankruptcy.

3.2.081 *Discharge of the Debtor and Release of Debts:* We discuss *infra,* in 3.2.091 et seq., at some length, the concept of the status of a bankrupt. For the purpose of the discussion here, it is sufficient to point out that under the present Act a bankrupt is not entitled to a discharge as of right. The court may either grant or refuse an absolute order of discharge, suspend the operation of the order or grant it subject to terms or conditions.

3.2.082 The effect of the discharge is to release the bankrupt of all claims provable in his bankruptcy, except:

(a) a fine or penalty imposed by a court or a debt arising out of a recognizance or bail bond;
(b) any debt or liability for alimony;
(c) any debt under a maintenance or affiliation order or under an agreement for maintenance and support of a spouse or child living apart from the bankrupt;
(d) any debt arising out of fraud, embezzlement, misappropriation or defalcation while the bankrupt was acting in a fiduciary capacity;
(e) any debt or liability for obtaining property by false pretenses or fraudulent misrepresentation;
(f) liability for the dividend that a creditor would have been entitled to receive on any provable claim not disclosed to the trustee, unless such creditor had notice or knowledge of the bankruptcy and failed to take reasonable action to prove his claim; or
(g) any debt or liability for goods supplied as necessaries of life, the court having power to make such order for payment thereof as it deems just or expedient.

3.2.083 The effect of not releasing the bankrupt from certain debts on discharge is to give a privileged position to the creditors concerned. They have the right to share in the property of the debtor, at the date of his bankruptcy, as well as the right to claim against the property he acquires after his discharge.

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[49] Section 96, *Bankruptcy Act,* R.S.C., 1952, C. 14, as amended by 1966-67, C. 25 and 32.

3.2.084 The concept of the conditional discharge and the less than complete release of debts, in a large measure, reflect the former quasi-criminal character of bankruptcy. It, in effect, operates as a penalty or a sanction against the bankrupt.

3.2.085 We are of the opinion that much of the rehabilitative effect of his discharge and release from debts is lost, when a bankrupt is left with substantial debts after his discharge. Indeed, in some cases, it may almost be regarded as a mockery of the bankruptcy system to take all of the sizable property of a debtor, distribute it among the creditors and then leave the debtor to cope with some of his largest creditors from whose debts he has not been released. If the *Bankruptcy Act* is not entirely commercial legislation at its present stage of development, it certainly is no longer criminal legislation. If the conduct of a debtor is criminal, the penalties or sanctions imposed against him should be those of the criminal law. The bankruptcy process should be used only to impose settlements upon the conflicting claims between a debtor and his creditors and claims between the creditors themselves. This is not to say that commercial morality is not to be encouraged. This, however, in our opinion, may be done more effectively by extending the restrictions inherent in the status of a bankrupt than by penalizing the bankrupt by not releasing him from his debts.

3.2.086 Almost two hundred years ago, Lord Mansfield said that ". . .all the debts of a bankrupt are due in conscience, notwithstanding he has obtained his certificate; and there is no honest man who does not discharge them, if he afterwards has it in his power to do so".[50] Certainly, many bankrupts would not dispute this, although, admittedly, the possibility of repaying any substantial payment on the debts from which they have been released is, in the case of most bankrupts, no more than wishful thinking on their part. It is, nonetheless, an ambition that should not be discouraged. Unfortunately, some creditors take advantage of debtors, in this regard, often in their most vulnerable moment, when their pride and self-respect have been seriously hurt in having to resort to, or being forced into, bankruptcy. For example, they may trick the debtor into paying, by one way or another, debts from which he has been released. A debtor may also be pressed into agreeing, as a condition for a creditor not opposing the application for the discharge, that it would not release the debtor from a claim of a particular creditor. Moreover, a creditor may persuade the debtor to make a payment on account of a debt from which he has been released or otherwise acknowledge that he is bound or will pay it, in order that the claim against him may be legally revived.

3.2.087 We recommend, in the first place, that the debtor be released from all claims that may be proved against an estate, except a fine or penalty imposed by a court and the dividend a creditor would have been entitled to receive on any claim not disclosed to the trustee where such creditor had no notice of the bankruptcy. While this may not strictly be within the terms of our study, we suggest that consideration be given to the problem of the debtor against whom a fine or penalty has been imposed. While the debtor would not be released from such a debt

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[50] *Trueman* v. *Fenton* (1777) 98 E.R. 123.

through the bankruptcy process, we believe that consideration should be given to granting to some other agency, such as the Parole Board, the authority to make an order releasing him from such a debt. Someone who has committed a crime, perhaps early in life, who has been convicted and imprisoned and who has nothing to repay the fine or penalty imposed upon him should not have to face, for his lifetime, the burden of a debt that would, in effect, make it impossible for him to ever financially rehabilitate himself.

3.2.088 We recommend, in the second place, that the release of a debtor from his debts should be unconditional and take effect as of the date of bankruptcy. We further recommend that the release of debts should have the effect of extinguishing the liability of the debtor to pay the debt and that any express or implied promise to revive such liability be unenforceable.

3.2.089 We do not want to discourage a debtor from attempting to repay his debts after his discharge. Our only concern is that a debtor should not be put in the position where he may be tricked into paying a discharged debt. Whether or not a debtor wishes to make payments on account of a debt from which he has been released should be a voluntary decision on his part and the law should protect the debtor in this regard.

3.2.090 Past experience has shown that the temptation is great, on the part of some debtors, to abuse the bankruptcy process as an easy way to get rid of their legitimate creditors. While some debtors, in our modern society, can, not long after a bankruptcy, get again into the situation where bankruptcy is the only remedy to their problems, some procedure must be devised to protect creditors against the abuses of the unscrupulous ones. For these reasons, we recommend that the court should have the power to annul a release of debts resulting from a bankruptcy that has occurred less than five years after another bankruptcy, in any case where the debtor has, in effect, abused the bankruptcy process to the detriment of his creditors.

V The Effect of Bankruptcy on the Person of the Debtor

3.2.091 Under the present Act, the status of a bankrupt commences when a receiving order by the Court is made or an assignment is filed with the official receiver. It terminates when the debtor obtains his discharge. While a debtor has the status of a bankrupt, he suffers a number of incapacities. *The British North America Act*[51] provides, for example, that "The place of a Senator shall become vacant. . .if he is adjudged bankrupt or insolvent, or applies for the benefit of any law relating to insolvent debtors, or becomes 'a public defaulter'." Most corporations Acts prohibit a bankrupt from being a director. It is offence, under the *Bankruptcy Act* for a bankrupt to engage in trade or business without disclosing to all persons with whom he enters into a business transaction that he is an undischarged bankrupt. Similarly, it is an offence for a bankrupt to obtain credit for a purpose other than the supply of necessaries for himself and his family to the

[51] *The British North America Act, 1867,* 30-31 Vict., U.K.S. 1867 C. 3, s. 31.

extent of five hundred dollars or more, from any person, without informing that person that he is an undischarged bankrupt.

VI Special Provisions for Particular Debtors

3.2.092 By giving a special status to the bankrupt, it is possible for the business community to identify him and avoid extending credit to him. The good debtor, who has been honest and unfortunate, can, in most cases, expect an early discharge. The bad type of debtor, under the present Act, may be either refused a discharge or granted one under conditions during which the status of a bankrupt will continue.

3.2.093 There are, however, a number of weaknesses in the present system. In the case of an honest, but incompetent debtor, the court hearing an application for discharge may conclude that, while the bankrupt is honest and, for that reason, deserves an opportunity for a new start in life, he should not be granted a discharge too early because he has proved himself to be incompetent. In other cases, the discharge may depend upon the attitude of the creditors. If the creditors wish to harass the debtor, they can make it difficult for him to obtain an early discharge. Moreover, courts have a wide discretion in deciding whether a discharge should be granted, which is not uniformly exercised. In some areas, the courts are much more generous in granting discharges than they are in others. And even in the same area, some judges may well approach the question of discharge differently from others. To attach a condition for the payment of a sum of money to a discharge, in some cases, has the effect of condemning a debtor to bankruptcy indefinitely, unless the court should subsequently agree to set aside or modify the condition.

3.2.094 While the making of a receiving order against, or an assignment by, any person, except a corporation, operates as an application for discharge, some debtors ask that the application be waived or, else, some trustees automatically ask the debtor for a waiver, in order to avoid the responsibility of making the application. In other cases, the discharge is refused because the bankrupt is unable to attend or to afford the cost of retaining counsel to attend on his behalf, on the return of the application for his discharge. While it is impossible to ascertain how many undischarged bankrupts there are in the country, their number must be great. We are of the opinion that this is not a healthy condition for either the debtors concerned or the commercial community, whose members may not know whether they are dealing with an undischarged bankrupt.

3.2.095 We have expressed the view, *supra* (2.1.30 et seq.), that the present *Bankruptcy Act* has not sufficiently kept pace with the manner in which business is conducted through the use of the limited liability corporation. Not only is it most difficult to reach the controlling agents of a bankrupt corporation, but the sanctions that apply in the case of an individual bankrupt and the status of a bankrupt are largely meaningless in the case of a corporation. For these reasons, it is important that some procedure be devised so that the grossly incompetent or dishonest businessman who had been trading through the device of a corporation could be kept out of business, as if he had been trading under his own name.

3.2.096 For these reasons, we recommend that the legal status of a bankrupt should apply not only to all individual bankrupts, but also to such directors or

officers (including those who, in fact, control the affairs of the corporation) of a corporation who are, for example, either primarily responsible for the bankruptcy of a corporation or who have substantially aggravated its insolvency. In the latter case, the status of a bankrupt would extend to an officer or director of a bankrupt corporation only on the order of the court. The effect of bankruptcy attaching to the property of a bankrupt would not, in such a case, extend to this type of bankrupt, except in the circumstances described supra in 3.2.024 to 3.2.027.

3.2.097 The status of a bankrupt, in all cases, would continue for five years after the date of bankruptcy. To make it more difficult, if not impossible, for the bad type of debtor from being in a position to renew the methods he formerly adopted to the detriment of the business community, no contract in respect of which credit is extended by or to the bankrupt in the course of his carrying on a business would be enforceable. Any bankrupt could, however, at any time, but more than one month after the making of a bankruptcy order, apply to the court for a certificate terminating his status of a bankrupt. A certificate could be granted only if the bankrupt establishes that his bankruptcy was caused by circumstances beyond his control, that his insolvency was not substantially aggravated by his fault and that the public interest does not require him to be further prevented from entering into and carrying on a business.

3.2.098 In our view, the present concept of the status of a bankrupt has largely failed to accomplish what was intended because there was no clear distinction made between the effect of bankruptcy on the person of the debtor and the effect on his property. The recommendations that we make in regard to after-acquired property (*supra,* 3.2.046 to 3.2.050), and the discharge of the debtor and the release of his debts (*supra,* 3.2.087 and 3.2.088) are all based on that distinction, as are the recommendations contained in the preceding two paragraphs.

VI Special Provisions for Particular Debtors

3.2.099 Under the present legislation, some insolvent debtors are treated differently than others by reason of the nature of the services they supply. Banks, railways, and insurance companies are cases in point. When they become insolvent, they are suject to being liquidated under the special provisions of legislation other than the *Bankruptcy Act,* such as the *Bank Act,*[52] the *Railway Act,*[53] and the *Canadian and British Insurance Companies Act,*[54] or the *Foreign Insurance Companies Act,*[55] which are omnibus statutes regulating the entire industry concerned. In addition, the *Winding-Up Act,*[56] apart from its general provisions, has special Parts relating to the winding-up of both banks and insurance companies. *The Exchequer Court Act*[57] also contains certain provisions that apply in the case of the insolvency of railways. The insolvency of a Quebec savings bank is not governed by the *Bank Act,* but by the *Quebec Savings Bank Act.*[58] All this leads to

[52] 1966-67, Eliz. II, C. 87.
[53] R.S.C., 1952, C. 234.
[54] R.S.C., 1952, C. 31.
[55] R.S.C., 1952, C. 125.
[56] R.S.C., 1952, C. 296.
[57] R.S.C., 1952, C. 98.
[58] 1966-67, Eliz. II, C. 93

confusion and uncertainty and, what is more serious, the remedies and procedures available to a trustee under the *Bankruptcy Act* are not, as a rule, available to the liquidators acting within the provisions of these other statutes.[59]

3.2.100 Apart from banks, railways and insurance companies for which there is special legislation in recognition of their particular position in the economy of the country, there are other debtors who should be singled out for special treatment. We have in mind stockbrokers and investment dealers. The possible legal problems that can presently arise upon the bankruptcy of a member of these classes of debtors can add greatly to the costs of the administration of their estates and, in some cases, lead to injustice.

3.2.101 The relations between landlords and tenants, in the case of bankruptcy of the tenant, also deserve special consideration.

3.2.102 Earlier in this Report (*supra* 2.4.01 to 2.4.03), we recommended the passing of a new bankruptcy and insolvency statute for an 'integrated and comprehensive bankruptcy and insolvency system'. This would require the incorporation, into the new statute, of the special provisions relating to the insolvency of banks, railways and insurance companies now found in other federal legislation, and we so recommend. We also recommend that there be special provisions relating to the bankruptcies of stockbrokers and tenants. In the following paragraphs, some of the more important special features regarding these particular debtors are discussed.

3.2.103 *Banks:* Both the *Bank Act* and the *Quebec Savings Bank Act* contain special and almost identical provisions relating to insolvent banks. Provision is made, for example, for the appointment of a curator to an insolvent bank to supervise the affairs of the bank and protect both the rights and interests of its creditors and shareholders and ensure the proper disposition of its assets. A special order of priority for the payment of debts is also provided. There are also some provisions in the *Winding-up Act* relating to insolvent banks. We have no recommendation to make as to the substance of these provisions. We recommend, however, that, as a rule, an insolvent bank should be liquidated pursuant to the general provisions of the *Bankruptcy Act,* in the same manner as any other commercial debtor, except insofar as these general rules need to be modified to conform with the special provisions now contained in the *Bank Act,* the *Quebec Savings Bank Act* and the *Winding-up Act* relating to the liquidation of insolvent banks. This, in our mind, would both strengthen the procedure for the liquidation of insolvent banks and make it more equitable.

3.2.104 *Railways:* Under the present legislation, a railway may not be put into bankruptcy nor wound up under the *Winding-up Act.* This reflects the public policy that railways have a national importance and should not be permitted to be liquidated like any other debtor. There have, however, been many railway failures. Very often, when a railway failed, the line was turned over to the federal Government, which operated it as a part of the government railway system.

[59] For a discussion of these problems, see, *supra,* in 1.2.35 et seq.

Periodically, as the result of the recurring financial difficulties of railways, there have been a number of Commissions established to study the operation of the Canadian Railway system. There was, for example, the *Railway Inquiry Commission* of 1916 to study and report on the railway situation as it existed at that time. The report recommended that the Grand Trunk, the Grand Trunk Pacific and the Canadian Northern be handed over to a board of trustees to be controlled and managed on behalf of the people of Canada. This led to the creation of the Canada National Railway in 1919. In 1931, another Royal Commission was appointed to study the railways and transportation system of Canada. We briefly mention these matters to indicate that there has been a history of railway failures in Canada, but, in most cases, they have been treated on an *ad hoc* basis. While fully recognizing the national importance of railways, we do not see any valid reason why the creditors of railways should be deprived of their rights to the collective execution against the property of the railway through the general bankruptcy procedure.

3.2.105 We, therefore, recommend that a creditor of a railway should have the right to petition a railway into bankruptcy in the same manner that it could in respect to most other debtors. We recommend, however, that a petition for a receiving order against a railway should be served upon the debtor, the Canadian Transport Commission and the Minister of Transport. Proceedings on the petition would then be stayed for sixty days unless The Canadian Transport Commission and the Minister of Transport consents to the stay being lifted. This would provide an opportunity to re-finance the railway, at least on a temporary basis, or permit other arrangements to be made for its continued operation. If the debt of the claimant is not satisfied within the sixty-day stay of proceedings, he could thereafter proceed with the petition in the same way as against any other debtor.

3.2.106 *Insurance Companies:* An insolvent insurance company, as the legislation now stands, may not be made bankrupt, but may be wound-up under Part III of the *Winding-up Act.* This legislation is, however, out of date in that it is not well-adapted to conditions presently prevailing in the insurance industry.

3.2.107 Our first recommendation, with respect to insurance companies, is that Part III of the *Winding-up Act* and the sections relating to the liquidation of insolvent insurance companies now found in the *Canadian and British Insurance Companies Act* and the *Foreign Insurance Companies Act* be incorporated into the new *Bankruptcy Act.* We also recommend that in so doing certain revisions be made, the principal of which being the following:

i) A petition for a receiving order should be served upon both the debtor and the appropriate federal or provincial Superintendent of Insurance. Proceedings would then be stayed for sixty days, or until the Superintendent of Insurance consented to the stay being lifted, so as to permit him to enter into discussions with other companies with a view to having the business assumed by another company or group of companies; and

ii) In the distribution of an estate, the claims arising from the happening of the event insured against should rank before the claim of policy holders for unearned premiums.

3.2.108 *Stockbrokers:* In recent years, there have been a number of bankruptcies of stockbrokers. These have proved to be both difficult and expensive to administer. Almost every security, for example, found in the possession or under the control of a bankrupt stockbroker must be the subject of an individual investigation by the trustee to ascertain under what capacity the security was held by the stockbroker. This is necessary in order to ascertain the legal principles that should be applied in respect to any claim involving the security. The relationship between the stockbroker and the claimant could, among others, be that of a vendor and purchaser, an agent and principal or a bailor and bailee. Even when the relationship of the stockbroker in respect of the securities can be established, difficult questions arise where, for example, there is a deficiency in the securities in the hands of the stockbroker to meet his obligations or where the stockbroker has pledged customers' securities, often with securities of his own, to secure a loan that is unpaid at the date of the bankruptcy.

3.2.109 In order to reduce the cost of administration of the bankruptcies of stockbrokers and investment dealers and to provide for a more equitable administration, we recommend that a special uniform procedure be devised to handle and settle all claims by the customers of a bankrupt stockbroker. We further recommend that this procedure be substantially the same as that provided by Section 60e of the United States *Bankruptcy Act.* If these recommendations were implemented, a single and separate fund would be established consisting of all moneys and securities received, acquired or held by the stockbroker, except for securities that can be identified by customers and which have been paid for in full. Thereafter, all customers, irrespective of their relationship to the stockbroker, would constitute a separate class that would be entitled to share rateably in the fund on the basis of their net equities at the date of the bankruptcy. Any property becoming available to the trustee, after the liquidation of a pledge made by the stockbroker, would be apportioned between the general estate of the stockbroker and the fund, in the proportion in which the general property and the property of his customers constituted the pledge. A stockbroker would be defined to include dealers and it would be immaterial whether or not the stockbroker, in addition to providing services for customers, also traded on his own behalf.

3.2.110 *Landlords and Tenants:* The relationship of landlord and tenant gives rise to special problems, particularly on the bankruptcy of a tenant. The right of the trustee to take over the unexpired lease on the bankruptcy of a tenant, the rights and the position of a sub-tenant of a bankrupt tenant, whether or not a landlord should give credit for a deposit or rent paid in advance, whether the trustee may sell the lease with or without liability on his part, whether the trustee must give notice to the landlord when he proposes to vacate the premises and whether the landlord should be able to demand that the trustee elect to either retain or disclaim the lease, are all examples of the many problems that can arise on the bankruptcy of a tenant and that should be regulated.

3.2.111 Prior to 1923, the *Bankruptcy Act* contained a code that regulated many of these situations. However, in a case[60] decided in 1923, Mr. Justice Panneton held that these provisions were *ultra vires* of the federal Parliament. Parliament

re-acted quickly. The *Bankruptcy Act* was amended to delete these provisions. Shortly afterwards, most provinces amended their respective legislation, relating to landlords and tenants, to include therein the sections deleted from the *Bankruptcy Act.* These provisions do not, however, regulate many of the important questions referred to in the preceding paragraph. We are of the opinion that the judgment of *In Re Stober* does not correctly express the law. Legislation relating to insolvent and bankrupt tenants is, in our view, clearly within the legislative authority of the Parliament of Canada. We, therefore, recommend that provisions governing the relations of a landlord and tenant, on the bankruptcy of the tenant, be re-introduced into the *Bankruptcy Act.*

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[60] *In re Stober, ex parte Mark Woodman Investment Corporation,* (1923) 4 C.B.R. 34 (Quebec).

CHAPTER 3

LIQUIDATION OUTSIDE BANKRUPTCY

3.3.01 Attention was directed *supra* (in 2.1.23 to 2.1.28) to the fact that the *Bankruptcy Act* has not kept pace with the changing methods of corporate and commercial financing. One of the distinctive features of this has been the increasing use of secured credit.

3.3.02 *Increase in Secured Financing:* There are, no doubt, many reasons why secured financing has become more popular. We have already alluded to the fact, *supra* (in 2.1.25), that the *Bankruptcy Act* has proved to be inefficient in protecting unsecured credit. As the average dividend on all unsecured claims in all bankruptcies is about six cents on the dollar, the prospective credit grantor, who wishes to be protected, will rely more on receiving a security than on the collective execution procedure provided by the *Bankruptcy Act.* Financiers frequently advance funds by way of a debt secured by a variety of bonds, debentures and floating and fixed charges. This provides them both security and an assured rate of return on their investment. Among the methods of secured financing, at the wholesale level, is the consignment, the floating charge, Section 88 Security under the *Bank Act* and the factoring of accounts. Security instruments, at the retail level, include the conditional sale agreement, bill of sale and chattel mortgage and the lease. New personal property security legislation, such as the *Personal Property Security Act* of Ontario, which is based upon Article 9 of the United States *Uniform Commercial Code,*[1] provides for a more rational form of personal property security regulation based upon modern commercial methods of doing business and may well result in an increased volume of secured financing.

3.3.03 *Bonds and Debentures:* When very large amounts of money are advanced by way of debt, they are usually secured by bonds, debentures or other obligations that are sold to the public. These obligations are invariably issued under a formal trust document, which is usually known as a trust deed or a trust indenture. The

[1]See *supra* in 3.2.058

indenture contains terms and conditions upon which the obligations are issued and provisions as to the administration of the trust. Important powers are vested in the indenture trustee that permit him to take action on behalf of all the security holders to protect or enforce the security underlying the bonds or debentures. The individual security holder has no practical way to act on his own behalf in this regard. When default occurs under the trust indenture, the indenture trustee is often appointed receiver or receiver and manager. Very often, acting as such, his principal function is to liquidate the security.

3.3.04 *Liquidations by Secured Creditors:* With the greater use of secured debt, there is necessarily a corresponding increase in liquidations outside of bankruptcy. Whenever default occurs, realization of the security may take place without the debtor ever being placed in bankruptcy. This is what happened, for instance, in the case of *Atlantic Acceptance Corporation.* Even when there is a bankruptcy, the realization is not governed by the provisions of the *Bankruptcy Act,* as the latter provides that, as a rule, a secured creditor may realize or otherwise deal with his security in the same manner as he would have been entitled to realize it or deal with it, if the Act had not been passed. The value of the property liquidated by secured creditors outside of the bankruptcy process is much greater than the value of property liquidated in bankruptcy.[2] When the new personal property security legislation is enacted by the provinces, there will be a tendency towards each business man to have a single major supplier of credit due to the widely embracing security interests this legislation encourages. This has been the experience in the United States where Article 9 of the United States *Uniform Commercial Code* has been enacted in all but one of the States and we have no reason to believe that the experience will not be the same in Canada. With substantially all of a businessman's assets held by creditors as security for credit granted to him, bankruptcy is not a practical remedy when insolvency occurs, as there are few unencumbered assets available to unsecured creditors. It would therefore seem that the long term trend might well be an increasing number of receiverships and other liquidations outside of the bankruptcy process and progressively fewer commercial bankruptcies.

3.3.05 *Conflicts of Interests:* The present procedures whereby secured creditors liquidate their security interest in the property of a debtor can lead to abuses. The secured creditor, or the receiver acting on his behalf, is chiefly concerned that the proceeds of the liquidation will be sufficient to satisfy what is owing to him. He is only incidentally and indirectly concerned with the position of the junior secured creditors and the general body of unsecured creditors. While a receiver appointed by the court is an officer of the court and is expected to be neutral and impartial in the manner in which he conducts himself, this conflicts with his duty to the individual security holders, if as is often the case, the indenture trustee is also the receiver.

3.3.06 *Lack of Supervision over Liquidation:* While the trend has been, for a long time, towards more secured credit, with an increasing amount of property being liquidated outside of the bankruptcy process on the insolvency of debtors,

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[2]See *supra* in 2.1.26

legislation for the regulation and supervision of such liquidations has not kept pace. For the most part, the responsibility for the supervision of the liquidations and the imposition of necessary rules of procedure has fallen upon the courts. In some cases, such as in mortgage and hypothecary actions, very detailed rules of procedure have been developed to protect the encumbrancers and the debtor. In the case of receiverships, while there is a highly technical body of jurisprudence covering certain aspects of the law, it has not yet been reduced to a comprehensive body of rules. There is, for example, in the case of receiverships, no obligation on the part of the receiver to disclose how he proposes to liquidate the security nor is there any restriction on the duration of the liquidation process. Some receiverships may last for years and, during this time, the equity that other creditors might have in the property being liquidated may rapidly depreciate.

3.3.07 *Recommendations:* The recommendations that we make in regard to liquidations outside of bankruptcy primarily relate to liquidations by receivers. While not wishing to unduly restrict the right of an indenture trustee to enforce the security underlying a bond or debenture, we are of the opinion that, whenever the debtor is insolvent, whether or not it is bankrupt, there should be certain minimum requirements in the conduct of a liquidation, through a receivership, in order to protect the interests of junior bondholders and unsecured creditors. In this regard our principal recommendations are the following:

(a) only a receiver, who holds a licence to act as a trustee under the *Bankruptcy Act* and whose professional conduct is thereby indirectly controlled, should be able to act as receiver, manager or liquidator;

(b) the indenture trustee should not himself be the receiver and the other general restrictions as to the eligibility of a trustee to act in a bankruptcy, such as conflict of interest rules,[3] should also apply to receivers;

(c) the term of a receivership should not be longer than two years, but the term could be extended from time to time on the receiver showing cause, on notice to all creditors, why such an extension should be made;

(d) except where the estimated proceeds of the sale of the assets of the debtor would, to the satisfaction of the court, be insufficient to redeem in full the claims of the class of creditors that requested the appointment of a receiver, the receiver, within three months of his appointment, should call a meeting of all creditors of the debtor;

(e) at the meeting of creditors, the receiver should make a full disclosure of the circumstances surrounding the insolvency of the debtor and as to how he proposes to exercise the powers given to him by the court at the time of his appointment;

(f) the creditors should have the power to appoint a creditors' committee, which would have no direct control over the receiver, but would have the right to be informed of his plans as to the liquidation of the security;

[3] See *infra* 3.6.49 et seq.

(g) any interested person should be able to apply in a summary manner to the court for the review of any decision of the receiver; and
(h) the receiver should be required to pass his accounts once a year.

3.3.08 It is also our recommendation that the court should have the power to order, on the application of any interested person, that where the credit was extended for a business purpose, the liquidation of movable property by or on behalf of a secured creditor should be conducted according to the rules recommended in the preceding paragraph.

3.3.09 We believe that these recommendations will not seriously interfere with the administration of receiverships and of the other liquidations to which these rules would apply. Indeed, it might be argued by some that they do not go far enough. However, if these recommendations were implemented, the position of those who may now be adversely affected when such liquidations take place will be greatly improved. When further experience is available, it may be necessary to legislate in greater detail.

CHAPTER 4

CRIME AND THE PROTECTION OF OUR CREDIT SYSTEM

3.4.01 The problem of crime in our affluent society, especially in relation to bankruptcy, has been briefly discussed supra in 2.1.35 to 2.1.47. Experience has shown that there is great temptation, on the part of those who are on the brink of financial collapse or have already failed, to salvage, for their own personal advantage or that of their relatives or friends, whatever property can be kept away from the reach of their creditors. To achieve this, many debtors are prepared to compromise with their own conscience, if not with clear dictates of the law. Similarly, the temptation is great, on the part of many who have, directly or indirectly, the responsibility to liquidate property of debtors, to take undue advantage of their position for their personal gain. The danger is greater, of course, when the creditors, for whose direct benefit the estates are liquidated, do not, as is too often the case, actively look after their best interest.

3.4.02 *Civil Remedies*: There are, under the Common Law and the Civil Law, various remedies available when such situations arise. The law, for example, protects a party to a contract against fraudulent misrepresentations. There are many other remedies[1]. It is not necessary to review them all here. It is sufficient to note the deeply rooted concern of society for the protection and enhancement of commercial morality.

3.4.03 *Civil Remedies of the Bankruptcy Legislation*: It has also traditionally been one of the aims of bankruptcy legislation to foster high standards of commercial morality. It does, through various techniques, protect the credit system against the abuses of the unscrupulous and the dishonest. For example, one of the purposes of the provisions of the *Bankruptcy Act* permitting the avoidance of preferences given to certain creditors is undoubtedly to protect the soundness of our credit system. These provisions can be traced to a concern to ensure that creditors have

[1]Some of these remedies are contained in ss. 1032 to 1040 of the Quebec *Civil Code* concerning the avoidance of contracts and payments made in fraud of creditors (action paulienne).

confidence that the system will treat them fairly and equitably. The same thing can be said of the provisions relating to reviewable transactions[2].

3.4.04 Some of the changes that we propose with respect to, for example, piercing the corporate veil and holding the members of a corporate entity personally liable for the debts of the entity in certain circumstances (*supra* in 3.2.024 to 3.2.027) would considerably strengthen the Act in this respect, afford better protection to creditors and contribute to enhancing commercial morality.

3.4.05 Obviously, much more than the efficiency and fairness of the bankruptcy process is at stake. Many of these abuses that were reviewed *supra* in 2.1.35 ss., as it is the case, for example, of planned bankruptcies, would constitute, if they were allowed to continue unabated and unchallenged, a most serious threat to our credit system which is one of the key elements of our economy.

3.4.06 *Criminal Law Remedies*: The credit system is so basic, however, in an advanced economy and commercial morality so essential, that more than civil remedies are required. Traditionally, the criminal laws have been used to check the most flagrant abuses of the credit system. Many of the provisions of the *Criminal Code* can be explained by this concern for commercial morality. This is the case, for example, of Section 335 of the *Code* which makes it an offence for a debtor to dispose of any of his property with intent to defraud his creditors.[3] All these provisions are obviously designed to protect our credit system against the abuses of the dishonest and unscrupulous debtors. It is noteworthy that these provisions of the *Criminal Code* apply whether or not bankruptcy proceedings have been initiated. A key element of these offences is often the inability to pay the creditors. But when such inability is relevant, it does not matter whether the debtor has been adjudged bankrupt or not.

3.4.07 There are also provisions in the *Bankruptcy Act* dealing with similar situations. They apply only when bankruptcy proceedings have been initiated. To a certain point, there is duplication between these provisions and those of the *Criminal Code*[4], but generally the *Bankruptcy Act* applies to situations that have arisen within a limited period of time prior to the bankruptcy. This is not usually the case with the *Criminal Code*[5].

3.4.08 The *Bankruptcy Act,* on the other hand, occasionally makes it more difficult for the debtor, as is the case, for example, in section 156(e) which, once the prosecution has proven the destruction of books of account, imposes on the bankrupt the onus of proving that "he had no intent to conceal the state of his affairs". Under Section 340 of the *Criminal Code,* which creates a similar offence, the onus of proving the intention to defraud is on the Crown.

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[2]Section 67A of the *Bankruptcy Act,* R.S.C., 1952, C. 14, as amended by 14-15 El. II, Can. S., 1966-67, C. 25 and 32.

[3]See also ss. 303 and 304 (false pretense), s. 323 (fraud), s. 340 (falsification of books) and s. 345 (failure to keep proper books of account). But there are many other provisions.

[4]Compare, for example, s. 335 of the *Criminal Code* with s. 156(b) of the *Bankruptcy Act.*

[5]See, for example, ss. 303 and 304 of the *Criminal Code* (obtaining credit by false pretense) and s. 156(f) of the *Bankruptcy Act* (obtaining credit by false representations within twelve months before the bankruptcy).

3.4.09 *Proposed Improvements to the Criminal Offences Contained in the Bankruptcy Act*: We have examined the provisions of both the *Criminal Code* and the *Bankruptcy Act,* in this respect, and have come to the conclusion that a number of improvements, essentially of a rather technical nature, should be made. There does not seem to be any reason, for example, why most of the provisions of section 156 of the *Bankruptcy Act* should apply only when the offence has taken place within twelve months prior to bankruptcy. Whenever a time limit is justified, there does not seem to be any reason why it should be anything less than five years. Similarly, section 156 provides only for a jail penalty which, understandably, some courts find difficult to impose in cases of lesser importance. The Act should leave to the courts the alternative of imposing a fine instead of a jail penalty.

3.4.10 The offences created by the *Bankruptcy Act* apply to individuals and firms as such, as opposed to their members. Section 162 of the Act, however, provides that, where an offence has been committed by a corporation, every officer, director or agent of the corporation who directed, authorized, condoned or participated in the commission of the offence is liable to the like penalties as the corporation and as if he had committed the like offence personally. It is, of course, necessary, as this section attempts to do, to have the means of reaching, behind the corporation, the individuals who are responsible for the illegal activities complained of.

3.4.11 It is not clear, however, whether the technique followed by the draftsman of the *Bankruptcy Act* is the best one. It seems that, as is done under the *English Companies Act* (s. 328 ss.), it would be simpler and more straight-forward to directly make it an offence for any officer or director of a company to indulge in certain abuses. This technique would be preferable to the present one, which requires the evidence of an offence on the part of the corporation before individuals can be convicted. This condition, in certain cases, could well be difficult to satisfy even though an offence could otherwise be retained against an individual officer or director. This is an area that requires clarification and simplification.

3.4.12 On the whole, however, we have reached the conclusion that generally the provisions of both the *Criminal Code* and the *Bankruptcy Act* are broad enough to afford adequate protection to creditors against abuses.

3.4.13 *Administrative Offences*: The present *Bankruptcy Act,* and this would be true of the one we recommend, imposes various obligations on a number of persons, such as the bankrupt, the trustee, the inspectors, in order to ensure that the purpose and intent of the legislation are carried through. One way to make sure that these duties are performed is, of course, to make it an offence for those who contravene. The provisions of the *Bankruptcy Act* that create such offences, which are often referred to as "administrative offences" to distinguish them from the criminal offences discussed in the above paragraphs, have also been examined. We have come to the conclusion that some of these provisions should be modified. This is the case, for example, of section 159(2) of the Act which makes it an offence for an inspector to accept from the bankrupt or from the trustee an emolument of a kind other than, or in addition to, the regular fees provided for by the Act. Obviously, it is necessary to exclude, as the section does, from the application of

these provisions the case, for example, of the credit manager who is appointed inspector in a bankruptcy in which his employer, from whom he receives his remuneration, has a claim against the estate. But the present wording does not, however, cover the case of the inspector who receives from one other than the bankrupt or the trustee a payment in return for his consenting to the trustee selling property of the estate to a given purchaser, who would usually be the person making the payment. This is certainly a situation that requires correction. On the whole, however, the provisions of the *Bankruptcy Act* relating to "administrative offences" are adequate and do not require major modifications.

3.4.14 One matter deserves special mention. In the bankruptcy system proposed in this report, the status of "bankrupt" would be considerably different from what it is under the present Act. We have explained *supra* (in 3.2.091 et seq.) what this new concept would entail. Emphasis has been placed on civil sanctions, but criminal penalties would also be required to enforce the prohibitions that will be attached to the status of "bankrupt".

3.4.15 *The Problem of Enforcement*: Our conclusion, therefore, is that, in general, the provisions of the *Criminal Code* and the *Bankruptcy Act,* as they relate to criminal offences and administrative offences, adequately identify the situations or abuses that threaten our credit system. Anyone familiar with the serious public unrest that existed, especially in the early and mid-sixties, as a result of flagrant abuses of the credit system and of what seemed to be a grave deterioration of commercial morality in some quarters, may validly ask what was wrong then with the system. Evidently, it is not sufficient to itemize in the legislation the situations that should be checked if the credit system is to be adequately protected and if society is genuinely concerned with the general standards of commercial morality. The detection, the investigation and the prosecution of suspected offences have an importance that has not always been recognized in the past. The problem, in our view, is one, not so much of definition of offences, but one of enforcement where investigation squads, amongst others, have a key role.

3.4.16 It is fair to say that, not too long ago, the legislative and administrative arrangements for the detection and eradication of this kind of abuse were far from satisfactory. Before 1966, the responsibility for investigating irregularities on the part of debtors before their bankruptcy was largely that of the creditors acting through their trustee. Many provisions of the *Bankruptcy Act* are indicative of the intention of Parliament to give to creditors a key role in this respect[6]. While the creditors have, in some instances, been instrumental in the detection of abuses which have subsequently been prosecuted before the courts, the Canadian experience of the early sixties has clearly shown that, as a rule, creditors do not believe that it is in their interest to aggressively pursue, through their trustee,

[6]Examples of such provisions would include s. 8(13) empowering the trustee to initiate criminal proceedings with the authority of the creditors, the inspectors or the Court; s. 121(1) enabling the trustee, with the approval of the creditors or the inspectors, to examine under oath the bankrupt or any other person reasonably thought to have knowledge of the affairs of the bankrupt; s. 163(1) requiring the trustee to report to the Court any evidence that the bankrupt has committed an offence, and s. 163(3) pursuant to which the Court may order the trustee to initiate court proceedings for the prosecution of criminal offences.

suspicions, and in some cases even evidence, of offences to either the *Bankruptcy Act*, the *Criminal Code,* or other legislation. The well-known expression "creditors are not interested in throwing good money after bad" has some relevance here.

3.4.17 One conclusion that can be drawn from the Canadian experience of these years is that it is most unrealistic to expect creditors to perform what is in essence a police function. The benefit that can accrue to individual creditors, as a result of their aggressively pursuing suspicions of offences or irregularities on the part of debtors, is much too precarious to be considered a worthwhile incentive.

3.4.18 The agencies responsible for the administration of the criminal laws within the provinces were not of great assistance to the creditors in these years. The tendency for many of these agencies was to take the position either that the responsibility for the investigation of such cases was that of the trustee or the Superintendent, or that an investigation could not be initiated unless the creditors or the trustee could come up with some good evidence of an offence, or that the real problem was civil rather than criminal in nature.

3.4.19 Finally, the Superintendent of Bankruptcy, although vested with powers of supervision and investigation with respect to the activities of trustees, did not have the legislative authority nor the staff to investigate suspicions of irregularities and abuses on the part of debtors prior to bankruptcy.

3.4.20 It should not be surprising, under these circumstances, that some succeeded in taking advantage of the weaknesses of the system. Since the passing of the 1966 amendments to the *Bankruptcy Act,* the situation has, however, greatly improved. The Superintendent has now the duty to investigate suspicions of offences against the *Bankruptcy Act* or any other statute of Parliament. This kind of investigation is, in many cases, very complex and time-consuming and, for this reason, the Superintendent, in the discharge of these functions, has the assistance of investigators of special expertise. Many police agencies, including the Royal Canadian Mounted Police, have also, in recent years, developed an expertise in this difficult field and are now working in close liaison with the Superintendent and between themselves towards a better enforcement of the laws in the field of bankruptcy.

3.4.21 We have given particular attention to the provisions of the *Bankruptcy Act* relating to the investigatory process and the administrative arrangements that have been devised in recent years, and have come to the conclusion that, although they are, on the whole, adequate, there is room for improvement.

3.4.22 Under the *Bankruptcy Act,* the Superintendent may launch an investigation only after a receiving order has been made or an assignment filed. This is unduly restrictive as, often, circumstances may well exist where, in the public interest, an investigation should be initiated before bankruptcy occurs. Serious damage can result to the public, whether they be consumers or suppliers, before the court may be in a position to bring individuals or firms formally under the purview of the *Bankruptcy Act.* For these reasons, the responsibility of the Superintendent to launch investigations should not be restricted to cases where a receiving order has been made or an assignment filed, as is the case presently. He should be permitted

to start an investigation whenever there are reasons to believe that an offence has been, or is likely or is about to be committed. This additional responsibility should, however, be limited to cases where there are reasonable grounds for suspecting that the abuses complained of have resulted or are likely to result in the insolvency of the individual offender or of the firm behind which the suspected offender may hide himself. Any special power given the Superintendent for the purpose of these investigations should, however, be exercised only under the supervision of the Court or a quasi-judicial tribunal, such as the Restrictive Trade Practices Commission. As a complement to the power to launch an investigation in such circumstances, the Superintendent should be authorized to initiate bankruptcy proceedings against the debtor in any case where, as a result of the investigation, the suspicions of offences and of an impending bankruptcy are confirmed.

3.4.23 Similarly, the Superintendent should be empowered to investigate offences under the *Criminal Code* that have been designed to protect the soundness of our credit system. This should be so, for example, in the case of section 340 (falsification or destruction of books of account with intention to defraud creditors) and section 345 (failure to keep proper books of account).

3.4.24 It is necessary, if the Superintendent is to fully play his role in regard to the protection of the credit system as a whole, that he be empowered to intervene in situations where insolvency and offences are seriously suspected, although not yet crystallized by the legal process, as well as in circumstances where it can reasonably, and logically, be presumed that an insolvency situation is developing, which should be, in the public interest, prevented from developing further.

3.4.25 The Superintendent is in a good position to assume this extended role, in the two areas mentioned *supra* (in 3.4.22 and 3.4.23), because of his overall responsibilities under the *Bankruptcy Act* and the reservoir of expertise that he already has and will undoubtedly continue to develop in the future.

3.4.26 Because the administration of criminal justice in Canada is, generally speaking, the responsibility of the provinces, the Superintendent has made arrangements with the provinces regarding the prosecution of offences to the *Criminal Code* that have been investigated by the Superintendent. These arrangements, which allow the Federal Department of Justice to prosecute by courtesy of the provincial authorities involved, have not presented unsurmountable difficulties. The investigating authorities should, however, as a rule, be in a position to take, before the courts, the matters that they have investigated. The need is especially great in the case of time-consuming, complex investigations, as often happens in the field of bankruptcy. It is a simple requirement of administrative efficiency. It seems essential that, for these reasons, the authority of the Attorney General of Canada to take before the courts the matters that have been investigated by the Superintendent, without the intervention of the provincial authorities, be placed beyond doubt. This result could be effected simply by incorporating in the *Bankruptcy Act* these offences in respect of which the Superintendent should assume special responsibility, as the Attorney General of Canada has authority, under the *Criminal Code,* to prosecute before the court offences to federal statutes other than the

Criminal Code[7]. This would not prevent the provincial authorities, on the other hand, from investigating and prosecuting suspected offences to these provisions.

3.4.27 We are convinced that the proposals made in this chapter, if they were to be implemented, would ensure that justice be done to those who place themselves outside the standards of conduct generally accepted by the business community and would thus contribute to maintain the confidence of the public in the soundness and fairness of the Canadian credit system.

[7]Paragraph (2) of s. 2 of the *Criminal Code* defines "Attorney General" to mean: "The Attorney General or Solicitor General of a province in which proceedings to which (the *Criminal Code*) applies are taken and, with respect to (a) the Northwest Territories and the Yukon Territory, and (b) proceedings instituted at the instance of the Government of Canada and conducted by or on behalf of that Government in respect of a violation of or conspiracy to violate any Act of the Parliament of Canada or a regulation made thereunder other than (the *Criminal Code*), means the Attorney General of Canada. . ."

CHAPTER 5

CRIMINALS AND THE BANKRUPTCY PROCESS

3.5.01 *A proposed New "Act of Bankruptcy":* In 1965, the Law Society of England submitted a brief to the Royal Commission on the Penal System in which it was suggested that the *Bankruptcy Act* be amended so that "the fact of conviction for any indictable offence occasioning loss or damage to property which has not been the subject of restitution by the defendant would constitute an act of bankruptcy." In this respect, the brief contained the following explanations:

> Thereafter it would be competent for either the Official Solicitor or some other suitably qualified Government appointed agent to secure the making of an order of adjudication in bankruptcy against the offender under a simplified and shortened procedure. It would be competent for such official to take all possible steps to recover as much of the proceeds of the crime as he was able, to set aside transactions which had been previously effected with a view to protecting the miscreant against loss of property or income which he would have otherwise possessed, and generally to take all steps within his power . . . to ensure both that the offender was deprived of his gains and that those who had lost or suffered as a result of his criminal activity be compensated wholly or in part out of the moneys so provided."[1]

3.5.02 The principal reason for the proposed recommendation is, "that the punishment most calculated to deter those minded to commit those crimes which are actuated by a desire for the acquisition of gain is the knowledge that upon conviction, they and their families will be deprived of the fruits of the criminal activity." The aim of those who advocate such a reform is to make available the investigatory powers of the bankruptcy process over the estates of convicted criminals and to provide for the speedy enforcement of certain claims against them.

3.5.03 Although the purpose is laudatory, we believe that there is an inherent danger in using the bankruptcy process as an arm of the criminal law. Originally, bankruptcy was treated as a crime. In the early statutes, the debtor was described as an offender and, in practice, was considered something close to a criminal whose property might be seized and whose person imprisoned. Over the centuries, the

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[1]COUNCIL OF THE LAW SOCIETY OF ENGLAND, *Memorandum submitted to the Royal Commission on the Penal System* on July 1965, p. 7. See also a second Memorandum of the COUNCIL, dated February 1966.

trend has been to separate more and more the bankruptcy process from the criminal process. We are of the opinion that this trend must continue and it would be unfortunate if it were reversed.

3.5.04 *Misuse of the Bankruptcy Investigatory Powers:* Perhaps the principal attraction of this recommendation is that the investigatory powers of the *Bankruptcy Act* would be available to assist in tracing the fruits of criminal activity. We are of the opinion, however, that these powers should be used only in reference to insolvent debtors. The fact that a debtor is a criminal should be irrelevant for the purpose of the bankruptcy process, unless he has been found to be insolvent. Any device designed to use the bankruptcy process against those who are not insolvent should be resisted. If investigatory powers similar to those available under the *Bankruptcy Act* are desirable to deprive solvent convicted criminals of the fruits of their crimes, such powers should be given to another agency of government so that it may do directly what is now suggested be done indirectly through the bankruptcy process.

3.5.05 *Enforcement of Claims and Criminal Activity:* Apart, however, from the fact that the implementation of this recommendation may serve as a greater deterrent to those who commit criminal offences for the acquisition of gain, it might also be said that it would facilitate the compensation of the victims of this type of criminal activity.

3.5.06 Bankruptcy is one method, indeed the ultimate method, available to enforce a judgment. In certain areas of the law, the traditional methods of enforcing judgments leave much to be desired. There is, for example, very little connection, if any, between the criminal and the civil courts. This often imposes great hardship on the victim of a criminal in any attempt to obtain restitution of property lost as a result of the crime, or compensation for damages to property. As a rule, two trials are necessary: one in the criminal court, the other in a civil court. The question, therefore, in this context, is whether the bankruptcy process should be used to make a bridge between the civil and criminal courts.

3.5.07 It is doubtful that the proposed reform would provide any great practical benefit to the vast majority of victims. If one is principally concerned with the innocent victim, more could be done for him, it would seem, through some scheme of Compensation Board for the victims of criminals. The Board, through a right of subrogation, would be in a position to pursue the claim of the victim.

3.5.08 The strongest argument for the proposed system is that it would seem to provide a simple and expedient method of execution against a criminal debtor when he has assets and the claim of the victim is liquidated. This, however, is not a valid argument. There would seem to be no reason why the victim of a criminal offence should not first obtain judgment (which could be pursuant to Section 628 of the *Criminal Code*) as is the case with any other debtor, and then present a bankruptcy petition. Most provincial Judicature Acts and, in the Province of Quebec, the *Code of Civil Procedure* provide protection when it appears to be just and convenient to prevent any waste or dissipation of assets.

3.5.09 *The Liquidation of Claims:* Section 628 of the *Criminal Code*[2] provides a summary procedure to obtain a judgment for damages in a criminal court. It has not proved particularly effective probably because, in most cases, the damages are difficult to liquidate. It must be said that this type of case is not much easier to administer under the *Bankruptcy Act.* Experience has shown that the court is reluctant to liquidate a claim under its bankruptcy jurisdiction. As a result, the summary bankruptcy procedure is not available and the claim has to be liquidated by the court under the ordinary, but less expeditious, procedure.

3.5.10 The proposed system provides for an automatic bankruptcy in the case of every crime occasioning loss or damage to property for which there has been no restitution, whether or not the criminal is solvent. However, the bankruptcy process is primarily designed for, and should be confined to, the administration of the estates of insolvent debtors. We do not believe, for example, that a solvent person convicted of a crime should be put into bankruptcy when the only reason that prevents him from satisfying the victim's claim is the fact that such claim is unliquidated. It might, however, be suggested that the conviction of a person in a criminal court of a crime occasioning loss or damage to property, for which there has been no restitution, should constitute an additional presumption of insolvency. The criminal would then be brought into court and be required to rebut the presumption by proving that he is, in fact, solvent. There would, however, be the same difficulty which has already been referred to. In many cases, it would be impossible for the criminal to prove that he could pay all of his debts including the claim of the victim without knowing its amount. To accept such a suggestion would raise the same problems and difficulties as those raised by an automatic bankruptcy.

3.5.11 *Our Recommendation:* We have already recommended *supra* (in 3.2.064) that unliquidated claims be provable in bankruptcy and that they be liquidated under the summary procedures of the *Bankruptcy Act.* This would apply whether or not the unliquidated claim results from criminal activity. Section 628 of the *Criminal Code* could also be amended to facilitate the liquidation of claims. There would, for example, appear to be no reason why a criminal court, on the request of the victim, could not be required to make an estimate of the value of the unliquidated claim against the criminal, instead of requiring it to find the actual

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[2]S. 628 of the Criminal Code reads as follows:

"(1) A court that convicts an accused of an indictable offence may, upon the application of a person aggrieved, at the time sentence is imposed, order the accused to pay to that person an amount by way of satisfaction or compensation for loss of or damage to property suffered by the applicant as a result of the commission of the offence of which the accused is convicted.

(2) Where an amount that is ordered to be paid under subsection (1) is not paid forthwith the applicant may, by filing the order, enter as a judgment, in the superior court of the province in which the trial was held, the amount ordered to be paid, and that judgment is enforceable against the accused in the same manner as if it were a judgment rendered against the accused in that court in civil proceedings.

(3) All or any part of an amount that is ordered to be paid under subsection (1) may, if the court making the order is satisfied that ownership of or right to possession of those moneys is not disputed by claimants other than the accused and the court so directs, be taken out of moneys found in the possession of the accused at the time of his arrest."

amount of damages suffered. If the criminal does not thereafter pay into court the amount of the estimate or give security for the same, this fact could then be used as a presumption of insolvency in the bankruptcy process. Such a provision enabling the court to estimate the value of an unliquidated claim is not unlike certain provisions in the *Income Tax Act* requiring the payment of an estimated tax and in certain expropriation statutes that require the expropriating authority to pay a certain percentage of the estimated value before it takes possession of the property.

3.5.12 We are, therefore, of the opinion that, although there are some compelling reasons to improve the procedure to liquidate claims, it would be a mistake to use the bankruptcy process against anyone but insolvent debtors. With this reservation, we believe that the problems that the recommendation of the Law Society of England was designed to solve should be approached directly through a re-examination of certain features of the criminal law process such as Section 628 of the *Criminal Code* and the powers and responsibilities of peace officers to investigate criminal conduct and, in particular, to trace and locate the fruits of criminal activity. In our view, it would be unwise to manipulate the bankruptcy process to do, indirectly and probably less satisfactorily, what could be better and more satisfactorily accomplished by direct action at the real source of the problems.

CHAPTER 6

THE ADMINISTRATION

3.6.01 No bankruptcy legislation can function adequately unless the administrative mechanisms supporting it are designed to fulfill the social and economic goals of the legislation and to prevent the possible abuses of the process. For that reason, it is imperative to discuss the question, as we propose to do in this chapter, whether the creditors or the state should have the primary responsibility for the administration of the bankruptcy system proposed in this Report.

3.6.02 To a great extent, the answer to the question depends upon an assumption as to whether the creditors or society as a whole have the greatest interest, economic, social or otherwise, in the bankruptcy system. In answering this question it is important to keep in mind the major weaknesses of the existing administrative mechanisms.[1]

I The Failure of Creditor Control

3.6.03 The method of control over the administration of bankruptcies varies from country to country. It is not without interest to know, however, that, in almost all bankruptcy systems, creditors were originally given the primary responsibility for the administration of estates. This was so because it was considered that bankruptcy resulted in the debtor's assets constituting a "trust", or something similar, for the benefit of the creditors, who were the beneficiaries. Control was gradually taken away from creditors, when it became accepted that there was a public interest involved in the bankruptcy system, in addition to private interests.

3.6.04 *England*: In England, prior to 1831, creditors had full control over the administration of estates in bankruptcy. "On all hands, the most general dissatisfaction was expressed which was no other than a chaos".[2] In 1831, England

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[1] *Supra* in 2.2.01 et seq.

[2] Joseph CHAMBERLAIN, March 19, 1883, on the second reading of the *Bankruptcy Act, 1883*, U.K., *Hansard's Parliament Debates*, 3rd series, vol. CCLXXVII.

began an experiment with official liquidation. A separate Bankruptcy Court was created and provision was made for joint administration of official assignees and assignees chosen by creditors. In 1869, as a result of pressure from the trading community, the system of official assignees was abolished and creditor control was revived. Creditors chose the trustee who was supervised by a committee of inspection chosen by the creditors. This "again led to absolute chaos and gave general dissatisfaction".[3] Among the abuses that arose was the solicitation of proxies by those not vitally interested in the estate, with the result that bankruptcy administration was often controlled and manipulated by persons adverse in interest to that of the main body of creditors. In 1883, the new Act, introduced by Joseph Chamberlain, recognized that creditor control had in fact failed and bankruptcy reverted to a system in which official control plays a large part. In *Australia,* the present *Commonwealth Act* is substantially based on the *English Act* of 1883.[4]

3.6.05 *France*: Much the same history of creditor control is found in France.[5] Under the *Code de Commerce* of 1807, the trustee had to be chosen among the creditors. Since then, the role of the creditors in the administration of estates has declined, while the judicial character of bankruptcy proceedings has become more pronounced. The evolution of the trustee from being a creditor to a "neutral" official was completed by the Decree of 1955. This Decree prohibits the appointment of a creditor as a trustee. A second Decree, in 1955, set up a professional organization of trustees to which all trustees must belong. A number of trustees are assigned to each court, from whom the trustee for any particular estate is selected by the court. The trustee, while still the representative of the creditors (the "masse"), is the mandatory or agent of the court and administers the estate under its supervision and direction. All important decisions must be authorized by the "juge-commissaire". Almost the only remnant of creditor control is the office of "contrôleur". The "juge-commissaire" may appoint "contrôleurs" from among the creditors. It is not mandatory, however, that they be appointed and their powers are not clearly defined. Their principal duty is to generally supervise the administration of an estate, but their authority is more apparent than real.

3.6.06 *United States*: In the United States, bankruptcy legislation provides for more court or judicial control than creditor control.[6] The second *United States Act*, passed in 1841, provided that the assignee (trustee) was to be appointed and removed by the court, at its discretion. In the Act of 1867, creditors were permitted to choose their own trustee, but the creditors' choice was subject to the approval of the court, which could either appoint additional assignees or order a new election. The Act of 1898, which is basically the present United States Act, gave the creditors "an unqualified right to appoint their own trustees". However, the United States Supreme Court, pursuant to its power to make rules, required the

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[3] *Ibidem.*

[4] Report of the Committee appointed to review the Bankruptcy Law of the Commonwealth, 1962, Commonwealth Government Printer, Canberra.

[5] Catherine LABRUSSE, *L'Evolution du Droit Français de la Faillite depuis le Code de Commerce.* In *Faillites,* Dalloz, 1970, p. 5 et seq.

[6] E. LEVI and J. MOORE, *Bankruptcy and Reorganization: A Survey of Changes,* (1937) 5 U. of C. Law review, 1, at p. 31 to 40.

appointment of trustees to be subject to the approval of the court. The amendments of 1938 gave legislative sanction to the necessity of this approval and permitted the court to make the appointment where the trustee, appointed by the creditors, failed to qualify. This, insofar as the appointment of trustees is concerned, was a reversion to the provisions of the Act of 1867. In the actual administration of an estate, the Referee, who is the trial judge of the Bankruptcy Court, supervises the collection and distribution of the bankrupt estate. In practice, the collection and administration, however, are done by the trustee.

3.6.07 *Canada*: In Canada, there has been a wide variation in methods of controlling or supervising administration. They vary from systems of strict creditor control, such as that of the *Bankruptcy Act, 1919,* to court control in proceedings under the *Winding-Up Act, Companies' Creditors Arrangement Act* and to a mixture of official and creditor control under the present *Bankruptcy Act.*

3.6.08 The first indication of official control, in Canada, appeared in 1923[7] when the office of the official receiver, modelled after the English official receiver, was introduced in an attempt to cure the abuses surrounding the appointment of trustees. However, the official receiver was not a true receiver, as is the case in England, his main responsibilities being similar to the ones he has under the present Act. The office of custodian was also created, primarily to prevent either the debtor or the petitioning creditor from selecting the trustee. The main duty of the custodian was to take possession of the property of the bankrupt and call the first meeting of creditors at which the trustee would be appointed. This is a function that, in England, is performed by the official receiver. The system of custodians did not work in Canada, mainly because it had been provided that he was to be appointed ". . . as far as possible . . . from the most interested creditors".[8] In practice, a creditor was almost never appointed custodian. Creditors had neither the time, facilities, experience nor inclination to carry on these duties.[9] The fact that creditors refused to accept appointments to be custodians resulted in the practice of the appointment of a trustee as custodian, the same person being, in most cases, subsequently appointed trustee for the estate. As this defeated the principal reason for having a custodian, the office was abolished in 1949.

3.6.09 The creation of the office of Superintendent of Bankruptcy, in 1932,[10] constituted another step towards the greater participation of the state in the administration of bankruptcies. The Superintendent was then given the responsibility of supervising the administration of all estates and, for that purpose, vested with appropriate powers.

3.6.10 Generally speaking, the state is not, at the present time, involved in the direct administration of insolvent estates. Two exceptions, however, are worth noting. The first exception relates to Part X of the Bankruptcy Act where the

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[7] *Bankruptcy Amendment Act,* 13-14 Geo. V., Can. S. 1923, C. 31.

[8] Ibid, s. 11(4).

[9] The *Donovan Report* (for full title, see *supra*, p. 36, note 8), Bankruptcy Administration in Canada, p. 11 et seq. and p. 26 et seq.

[10] For a description of the duties of the Superintendent of Bankruptcy, see *supra* 1,3.26.

court has exclusive jurisdiction over the procedure for the orderly payments of debts. The second exception concerns the cases where the official receiver is called upon to perform the duties of trustee in the event of the death or other incapacities of the trustee appointed in the first place.[11]

3.6.11 *An Increased Role for the State*: Chapter 2 of Part 2 of this report shows that, notwithstanding the elaborate provisions designed to ensure good and effective creditor control of bankruptcy administration in Canada, creditor control, as in many countries, has failed. In theory, creditor control is neither better nor worse than official or judicial control. In our view, however, it is illusory to hope that creditors will generally be willing to fulfill, at their own expense, duties they are called upon to perform in the public interest. Even when their own private interest is concerned, experience, here and abroad, has shown that creditors often abdicate their responsibility in this respect.

3.6.12 For these reasons, we recommend that the principle of creditor control should no longer be relied upon as the cardinal principle upon which the administrative machinery of the bankruptcy system should be based. The machinery should undoubtedly be such as to allow those creditors who have a genuine interest in the administration of estates to involve themselves, but, at the same time, it should take into account the fact that, generally, creditors are not interested and do not participate in the administration of estates. In our view, the state should continue to assume greater responsibilities to fill the vacuum resulting from the fact that creditors abdicate their responsibility in the administration of bankrupt estates.

3.6.13 That the creditors have left a vacuum in bankruptcy administration is not, however, the major reason for a greater participation of the state in the administration of the bankruptcy process. The changes that have taken place in our society and described *supra* in 2.2, have rendered obsolete many of the traditional concepts of bankruptcy. With the increased use of credit, it is more important today than it was ever before that the public have confidence in the bankruptcy system. In effect, this means that the state has a specific role to play in the administration of the bankruptcy process and that it cannot count on others, such as creditors, to discharge its responsibilities in its place.

3.6.14 The question may be asked as to which branch of the State, whether the executive or the judicial, should have the primary responsibility for the control of the bankruptcy process. The method of control adopted to replace or complement creditor control varies from country to country. For example, in the English and Australian bankruptcy systems, official or state control plays a large part. In the French system, the control is almost exclusively exercised by the court. In the United States, court control prevails, but without the overwhelming power and authority that the court has in France.

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[11] Section 6(3). The official receivers appointed from the staff of the Superintendent of Bankruptcy were, at the end of December 1969, performing the duties of trustee in 840 estates.

3.6.15 In Canada, it would be outside the ordinary scope of the functions of a court to have the responsibility to administer or supervise the administration of insolvent estates. In our judicial system, the court has no initiative power of its own and it decides only the questions that are formally brought before it. Fundamental changes in the organization of the judicial system would be required if administrative duties were to be entrusted to the courts in connection with the bankruptcy system. The Canadian experience with court control has been far from satisfactory. This is somewhat the type of control that prevails under the *Winding-Up Act*. It is because of the difficulties in adequately controlling the administration of estates under that Act that its use was restricted in 1966.[12] For all these reasons, we do not believe that it would be advisable to give to the courts the responsibility to control or supervise the administration of the bankruptcy system. This responsibility, in our view, should be that of the administrative branch of the government.

II Direct Responsibilities of the Government in the Administration of the Proposed System

3.6.16 In the following paragraphs, we shall discuss the major areas of responsibility that, in our view, the government should assume in order to make the bankruptcy process effective and efficient.

3.6.17 *Interim Receivers*: Under the present Act, a licensed trustee may be appointed to be an interim receiver of the property of a debtor after the filing of a proposal or a petition for a receiving order, if it is shown to be necessary for the protection of the estate. His main responsibility is to take possession of the debtor's property. In theory, the interim receiver is an officer of the court and takes instructions from it. In practice, as the petitioning creditor or his solicitor usually suggests the name of the proposed interim receiver and makes the preliminary arrangements with him, the interim receiver may often overlook the fact that he is an officer of the court and perhaps unconsciously slip into the attitude of mind that he is "hired" by the petitioning creditor or his solicitor and that he is, in fact, in some way responsible to them. As the interim receiver will, in most cases, hope to be appointed the trustee of the estate, if a bankruptcy occurs, he may consider it not to be in his interest to go against the wishes of the petitioning creditor, particularly if he happens to be one of the larger creditors.

3.6.18 One of the best known statements concerning judicial impartiality is that "it is of fundamental importance that justice should not only be done, but should manifestly and undoubtedly be seen to be done".[13] Put even more briefly, "Next to the tribunal being, in fact, impartial is the importance of its appearing so".[14] In our opinion, interim receivers cannot always be favourably measured by such

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[12] See *supra* in 1.2.05.

[13] *R.* v. *Sussex Justices, ex p. McCarthy,* (1924) 1 K.B. 256 at 259 per Lord Hewart C.J.; see also *Schooley v. Nye,* (1950) 1 K.B. 335 at 345, per Denning, L.J.

[14] *Shrager v. Basil Dighton Ltd.,* (1924) 1 K.B. 274 at 284, per Atkin, L.J.

standards. An interim receiver should be an impartial neutral officer of the court. An alternative to the present system would be to require a public official to be the interim receiver in all cases.

3.6.19 Some may feel that a public official will not have the ability and experience to make an effective interim receiver, having regard to the wide variety of enterprises of which he may be called upon to take possession. Certainly, there would not be the same experienced people immediately available to call upon. It would be expected, however, that very quickly there would be a well-trained, competent and increasingly experienced cadre of officers available to perform the duties of an interim receiver in almost any situation. Moreover, in particularly large and complicated receiverships, it would be possible for the interim receiver to appoint a special manager.

3.6.20 It is, accordingly, our recommendation that a public official should, in all cases, be appointed interim receiver. This recommendation should be considered in the context of the recommendation made *infra,* in 3.6.24, that the first trustee of every estate should also be a public official. If these recommendations taken together were implemented, the interim receiver and the first trustee would be the same person. This would promote a continuity in administration.

3.6.21 There is one other observation that needs to be made regarding interim receivers. The cost of an interim receiver may be substantial. There is presently no tariff of fees for interim receivers as is the case with trustees. Very often, an interim receiver, in small and medium size estates, is paid more in fees for being the interim receiver for a few weeks than he is subsequently paid as trustee for services lasting many months. We regard it only just and proper that there be a tariff of fees for interim receivers and we so recommend.

3.6.22 *The Choice of the Trustee*: If the public is to have confidence in the bankruptcy system, it is of crucial importance to avoid even the appearance of conflict[15] that results when the debtor or the petitioning creditor chooses, in fact, the trustee. It is also imperative that no debtor who needs the relief and rehabilitation that bankruptcy can give should be prevented from becoming bankrupt because he cannot afford the fee of a trustee. Similarly, no bad debtor should escape from bankruptcy by reason only of the fact that there is no creditor who will pay the fee of a trustee.

3.6.23 For these reasons, we recommend that, in every estate, a public official be the first trustee, from the date of bankruptcy to the date of the first meeting.

3.6.24 *Taking of Possession and Making of Inventory of the Debtor's Property*: In order to assist greatly in the controlling of abuses relating to the property of the bankrupt[16], we recommend that, as in England and Australia, a public officer, in all cases, initially take possession of the property of the bankrupt and make an inventory of it. We also recommend that a complete inventory be kept at all times

[15] See *supra* in 2.2.10 to 2.2.12.
[16] See *supra* in 2.2.15 to 2.2.19.

by the trustee, in which would be shown all property of the bankrupt that comes into his possession and the manner in which it is disposed of.

3.6.25 *A Dual System of Trustees*: The implementation of the recommendation contained *supra,* in 3.6.23 and 3.6.24, would, in effect, mean that licensed trustees would no longer have a role to play in the initial phases of the administration of estates in bankruptcy. This is not to mean, however, that private trustees could not play a useful role subsequently. At the first meeting, creditors should decide whether they wish to have a private trustee or a public trustee to administer the estate. If the creditors do not substitute a private trustee in the place of the public official, the latter will continue to be the trustee. Such a dual system of private and public trustees would provide the whole body of creditors with a real choice as to who should act as their trustee.

3.6.26 *The Board of Inspectors*: We have indicated *supra,* in 2.2.22 and 2.2.23, that the purpose of a Board of Inspectors was to permit the creditors, through the inspectors, to closely control the administration. Where an estate is administered by a private trustee, a Board of Inspectors should be appointed in every case, either by the creditors or, if they fail to do so, by a representative of the government. Furthermore, since the governments either federal or provincial, have a claim in most estates, we believe that, in order to ensure an efficient administration, the Superintendent, at the request of a representative of the Crown in the right of Canada or a province, in the cases where the Crown has a claim, should appoint one person as inspector, even in those cases where the creditors have appointed inspectors.

3.6.27 For these reasons, we recommend that there be provisions for the appointment of a Board of Inspectors in every estate, except with respect to estates in which a public official is the trustee. The Superintendent should also have the power to establish a Board and appoint inspectors, where the creditors have failed to do so. Finally, the Superintendent should have the power to appoint a representative of each of the Crown in the right of Canada or of a province to a Board of inspectors, in any case where the Crown has a claim and requests such an appointment.

3.6.28 *Arrangements for Small Debtors*: The need to provide a simple and inexpensive procedure permitting small debtors to make an arrangement by way of extension or composition with their creditors has been established *supra,* in 3.1.13 et seq. We believe that the government should assume the entire responsibility for the establishment and the maintenance of the necessary machinery to provide relief to small debtors in those circumstances.

III Supervisory Role of the Government

3.6.29 The federal government already has a responsibility for supervising the administration of the present bankruptcy system. The recommendations that follow are designed to adapt this existing role to new circumstances.

3.6.30 *The Licensing of Trustees*: Under the present Act a person is licensed to be a trustee by the Superintendent of Bankruptcy on the authorization of the Minister of Consumer and Corporate Affairs. The superintendent is required to make an investigation into the character and qualifications of an applicant for a licence. Applicants are also required to appear before a Board of Examination and to submit such information relevant to the application as may be required. In our view, this is a satisfactory procedure and it should be continued. We have considered the question whether an applicant, whose application for a licence has been refused by the Minister, should have a right of appeal of some kind from the Minister's decision. We have come to the conclusion that this is not necessary. No one can claim to have a right to have a licence to act as trustee in bankruptcy. The question whether a licence should be issued or not often revolves not only on the qualifications, trustworthiness and experience of the applicant, but also on other matters involving policy considerations, such as the volume of bankruptcy business or the number of trustees already licensed in any given district. It is appropriate, for these reasons, that the final decision as to whether a licence should be issued be that of the Minister responsible before Parliament for the administration of the Act.

3.6.31 *Corporate Trustees*: No licence to act as a trustee in bankruptcy has been issued to corporate entities in recent years. This results mainly from a concern that the supervisory authorities may not be in a position to adequately control a corporate entity because of the difficulties to attach responsibilities to the individuals behind the corporation. The licensing of corporate entities to act as trustees would, on the other hand, present a number of advantages, such as continuity of existence and greater flexibility of organization. Incorporation would also, in some cases, carry tax advantages. On balance, we have concluded and we so recommend, that it should be permissible for corporations, under certain requirements and subject to certain safeguards, to obtain a licence to act as a trustee. A corporation, however, the primary business of which is to act as a trustee in bankruptcy, should not be permitted to appeal to the public for funds. Similarly, a minimum number of directors and officers of such a corporate licensee should, as well as its principal managers, possess qualifications similar to those required of individuals who have a licence.

3.6.32 *The Disciplining of Trustees*: Under the present Act, the Superintendent of Bankruptcy issues, not only new licences, but also, subject to the approval of the Minister, renewals of licences. The Superintendent also makes recommendations regarding the suspension or cancellation of licences by the Minister. We have expressed the view, *supra,* in 2.2.33 et seq., that the relevant provisions of the Act, especially as they relate to the refusal to renew a licence, were not entirely satisfactory.

3.6.33 In our view, the law should make it a clear requirement for the Superintendent to put reasons in writing to the trustee whenever he proposes to suspend, cancel or refuse to renew a licence or proposes to renew it subject to a condition or restriction not already attached to it. The law should also provide that the trustee has the right to be heard by the Superintendent whenever the latter proposes to interfere, in any way, with his licence. Under the present Act, the final

decision, in any such case, is that of the Minister. We believe that the procedure for the disciplining of trustees should not only be, but appear to be, entirely free from political interference. For these reasons, we recommend that the final decision regarding the suspension or cancellation of a licence or the refusal to renew a licence should be that of an independent tribunal, such as the Restrictive Trade Practices Commission, and that for that purpose, the trustee whose licence is affected, should have the right to appeal from the Superintendent's decision. There should also be some special provisions permitting the Superintendent, under the authority of the tribunal, to take such conservatory measures as may be required to protect the interests of the creditors before a final decision is reached by the tribunal.

3.6.34 *An Indemnity Fund*: We have referred, *supra,* in 2.2.34 et seq., to the difficulties of obtaining satisfaction from bonding companies in cases where trustees have been guilty of misappropriation of funds or other fraud. We recommend that, in place of the present system of bonding, an Indemnity Fund be created to be administered by the Superintendent of Bankruptcy. Any person obtaining a judgment against a trustee for failure to duly and faithfully perform his duties as trustee of an estate would have the right to obtain an order directing payment, out of the Fund, of the amount of the judgment or the unsatisfied portion of it. Initially, trustees would pay into the Fund an amount equivalent to the premiums that they would have had to pay under the present system for both the general bond and the special bonds required when they are appointed to an estate. Unclaimed dividends held by the Receiver General pursuant to the Act should also be transferred to the Fund[17]. The amount paid by trustees, after the Fund has reached a certain level, for example, one million dollars could be reduced accordingly. The creation of such a Fund would not only help resolve the problem pertaining to the difficulties of obtaining satisfaction, but, in the long run, should result in substantial savings to trustees and creditors[18].

3.6.35 *The taxation of Accounts:* We have discussed *supra*, in 2.2.35 et seq., the present unsatisfactory arrangements for the taxation of accounts and the unnecessary duplication of work that results. Our recommendation in this respect is that the Superintendent be given the exclusive initial responsibility to audit and tax the statement of receipts and disbursements and accounts of interim receivers, trustees, receivers,[19] solicitors and accountants. Anyone dissatisfied with the taxation by the Superintendent should have the right to a review of the taxation by the Superintendent, with a right of appeal to the Court.

3.6.36 *Discharge of Interim Receivers, Receivers and Trustees*: Under the present Act, when a trustee has had his accounts passed, he may apply to the court for a discharge. The discharge has the effect of relieving the trustee from all liability in respect of any act done or default made by him in the administration of the estate

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[17]The unclaimed dividends in the hands of the Receiver General, as of July 1st, 1968, amounted to close to $465,000.

[18]According to an estimate made by the Superintendent of Bankruptcy, the amount paid in premiums each year is in excess of $100,000.

[19]The receivers referred to *supra,* in 3.3.07 et seq.

in relation to his conduct as trustee. We believe that the discharge of the trustee should be automatic upon the passing of his accounts and we so recommend. The same rule should apply to interim receivers and receivers.

IV Government Officials

3.6.37 It is appropriate to review briefly what the main responsibilities of the Superintendent of Bankruptcy and the Official Receivers would be under the new bankruptcy system that is proposed in this Report.

3.6.38 *The Superintendent*: As under the present Act[20], the Superintendent would have the responsibility to supervise the administration of all estates. In this respect, the law should specifically recognize to the Superintendent the power to give general directions to interim receivers, official receivers, receivers and trustees in the performance of their duties. As recommended *supra,* in 3.6.26 et seq., the Superintendent would have the power to appoint a Board of Inspectors, where the creditors have failed to do so, and, in some circumstances, to appoint a representative of the Crown to any Board of Inspectors. He would continue to have the powers, subject to the changes recommended *supra,* 3.6.30 et seq., to grant, renew, suspend or cancel the licence of trustees. He would have the responsibility to administer the Indemnity Fund, the creation of which is recommended, *supra,* in 3.6.34. Finally, it would also be the responsibility of the Superintendent to tax, as is recommended *supra,* in 3.6.35, the statements of receipts and disbursements and the accounts of interim receivers, trustees, receivers, solicitors and accountants.

3.6.39 In order to protect the confidence of the public in the credit system, we have recommended, *supra,* in 3.4.22, that the Superintendent should have, in addition to his present responsibilities regarding the investigation of offences, the responsibility to investigate certain suspected criminal or illegal pre-bankruptcy activities.

3.6.40 The present Act[21] requires every registrar and official receiver to keep an index of the names of each bankrupt in respect of whose estate a notice appears in the *Canada Gazette.* In practice[22], no registrar or official receiver keeps the records required by the Act in this respect and in no office of a registrar or official receiver is there, in fact, a complete list of bankrupts. We recommend that the Superintendent be given the responsibility to keep such records for all the country.

3.6.41 Under the present Act, many notices are required to be published in local newspapers and the *Canada Gazette.* The value of such advertising is at the best nominal. In small communities, an advertisement in a local newspaper would come to the attention of almost everyone. Most creditors today, however, learn of the

[20] Subsection (2) of Section 3, *Bankruptcy Act,* R.S.C. 1952, C. 14, as amended by 14-15 El. II, Can. S., 1966-67, C. 25 and 32.
[21] Section 167
[22] From a survey made by the Committee. See Appendices "B" and "C".

failure of their customers not through newspaper advertisements, but through trade journals and credit agencies. Even assuming that creditors do read bankruptcy notices in the back pages of newspapers, it would seem a very hit and miss method of informing them of a bankruptcy. In a three newspaper city, a very large percentage of the population would take one newspaper or less and only a very small percentage would take all three newspapers. The problem is compounded when there is, in any community, newspapers in several languages. There is, for example, nothing in the Act to prevent the notice of a bankruptcy of an English or French speaking debtor to be published in an Italian language newspaper. Similarly, the long and formal advertisements contained in the *Canada Gazette* seem to be an unnecessary and wasteful expenditure of monies. For these reasons, we recommend that the Superintendent should be required to publish, in a summary form, in the *Canada Gazette,* such particulars of bankruptcy proceedings as may be prescribed. The notice to be published would be a substitute for the advertisements and notices presently required to be published by trustees in local newspapers and the *Canada Gazette.* The implementation of this recommendation should result in substantial savings to creditors.

3.6.42 Finally, in order that Parliament may exercise an effective control over the administration of the Act, it is recommended that the Minister table annually in Parliament a Report regarding the administration of the Act.

3.6.43 *The Official Receivers*: We recommend that, as far as possible, all official receivers be full-time employees of the Public Service of Canada. Their duties and responsibilities would include the following:

(a) to be interim receiver in all cases when one is required (see *supra,* 3.6.20);
(b) to be the trustee in all estates up to the first meeting of creditors (see *supra,* 3.6.23);
(c) to take possession and make an inventory of all assets in each estate in bankruptcy (see *supra,* 3.6.24);
(d) to complete the administration of an estate, unless the creditors otherwise decide (see *supra*, 3.6.25);
(e) to be the trustee in every arrangement made by small debtors (see *supra,* 3.6.28);
(f) to represent the public interest on all applications to the Court regarding the status of a bankrupt (see *supra,* 3.2.086 and 3.2.087).

One official receiver should be appointed in each province with as many deputy official receivers, under his general direction, as may be necessary to fulfill the duties imposed upon them by the Act.

3.6.44 *The Official Receiver in Bankruptcy*: Under the Australian *Bankruptcy Act,* all of the official receivers together constitute a body corporate known as "The Official Receiver in Bankruptcy" for the purpose of holding property of bankrupts. The official receivers retain their identity for the general purposes of the administration of estates. The creation of such a body corporate, in Australia, was meant to "facilitate dealings in property and avoid the necessity for transmission from official receiver to official receiver when there is a change in the

person holding that office or a transfer of administration from one district to another"[23]. In view of the greater responsibilities and the enlarged role that is recommended for the official receivers, we are of opinion that the incorporation of the official receivers in bankruptcy, as has been done in Australia, would facilitate the operation of the Act in respect of the vesting of property in official receivers.

3.6.45 We, therefore, recommend that the official receivers together be constituted a body corporate to be known as the "Official Receiver In Bankruptcy", which should have perpetual succession and could, in its corporate name, acquire, hold or transfer any property and sue and be sued. Any official receiver would have the authority to do on behalf of the corporation what the corporation would be authorized to do.

V Other Problems of Administration

3.6.46 It is proposed to briefly discuss in the following paragraphs problems relating to meetings of creditors and conflicts of interests.

3.6.47 *First Meeting of Creditors*: The difficulty of obtaining a quorum at a meeting of creditors and the effect this situation has on the administration have been discussed *supra,* in 2.2.20 and 2.2.21. There are at least two approaches that might be taken to remedy this situation. The first one would be to provide that no meeting of creditors be held, unless a stipulated number of creditors request one. This approach must be discarded because it would involve a more lengthy and expensive procedure. A notice notifying the creditors of the bankruptcy would be required in every case and, if a meeting was later requested, a second notice to the creditors would become necessary. The second approach would be to call a meeting and permit the estate to be administered without the participation of creditors, if a quorum is not present at the meeting. Such an approach would have the merit of not depriving the creditors of any of their rights of control over the administration of an estate, should they choose to exercise them. If, however, the creditors do not show enough interest to at least attend meetings, the administration of the estate would not be delayed or prejudiced by their indifference.

3.6.48 We, therefore, recommend that a meeting of creditors be called at the commencement of the administration of every estate, but that, if a quorum is not present, the appointment of the official receiver as trustee be deemed to have been approved.

3.6.49 *Conflicts of Interests*: Whenever one has a conflict of interests, there is a danger, as indicated *supra,* in 2.2.24 to 2.2.27, that there will be abuse of power, damaging compromises and a loss of public confidence in the system. It is our view that a new *Bankruptcy Act* should regulate the question of conflicts of interests and provide guidelines to those involved in bankruptcy administration to assist them in ascertaining where their duty lies.

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[23]Report of the Committee appointed to Review the Australian Bankruptcy Act, 1962, para. 33, p. 15.

3.6.50 Generally, it is not easy to identify situations where a conflict of interests exists. But there are situations that can readily be identified and about which a relatively broad consensus can be obtained.[24] We have, for our part, come to the conclusion that a new *Bankruptcy Act* should define what is a conflict of interests. In our view, there is a conflict of interests, on the part of any person acting or proposing to act for an estate in any professional capacity, whenever such person is required, as a result of his services being retained by the estate,

(i) to support or reveal that which his duty to another person requires him to contest or conceal, or

(ii) to contest or conceal that which his duty to another person requires him to support or reveal.

Under such a test, a solicitor who acts for a petitioning creditor would be prevented from acting for the estate. A trustee for an estate would also be prevented from acting as agent for a secured creditor of the debtor for the purpose of liquidating the security. Similarly, an indenture trustee would be prevented from acting as receiver in the circumstances where the procedure recommended *supra* in 3.3.07 would apply.

3.6.51 Moreover, the Act should provide that a conflict of interests exists whenever a person has, at any time in the two preceding years, acted for or was related to or directly or indirectly, professionally or commercially, associated with the debtor. Under such a rule, a solicitor would be prevented from acting for the estate of his client subsequently placed in bankruptcy, unless the bankruptcy occurred more than two years after the debtor ceased to be the solicitor's client. Similarly, and subject to the same qualifications, the accountant or auditor of a debtor would be prevented from acting as trustee for the estate of the debtor and render any service of a professional nature to the estate.

3.6.52 It is our recommendation that everyone who has a conflict of interests should be prohibited from acting for an estate administered under the provisions of the Act.

VI The Courts

3.6.53 The recommendations we have made above were designed to relieve the courts from as many administrative responsibilities as possible and to prevent waste and unnecessary duplication of work with other services. If our recommendations were implemented, the court would no longer, except on appeal, be involved in the taxation of accounts (see *supra,* in 3.6.35), the discharge of trustees, (see *supra,* in 3.6.36) or bankrupts and arrangements by small debtors (see *supra,* in 3.1.21 to 3.1.25). It would, however, be called to play a most important function in issuing certificates, (see *supra,* in 3.2.097.) Generally, the court would, therefore, have an important role in all contentious matters, but administrative functions would be the

[24]See, for example, Rule 44 of the General Orders in Bankruptcy adopted by the Supreme Court of the United States, and Sections 55 and 56 of the By-Laws of the Bar of the Province of Quebec. See, also, Opinion number 17 of the Institute of Chartered Accountants of Ontario.

responsibility of the administrative branch of the government. In the result, the implementation of our recommendations should substantially reduce the burden of the courts in the bankruptcy process.

VII The Financing of the Proposed System

3.6.54 The implementation of the recommendations contained in this Report, especially those relating to the official receivers acting as public trustees and the administration of the provisions relating to arrangements by "small debtors", would require a substantial increase in the staff of the Superintendent. We believe, however, that the government services required to maintain an efficient bankruptcy and insolvency system should, except for those services that relate to the enforcement of the provisions relating to criminal activities and abuses, be self-supporting inasmuch as possible. In the cases where there are assets, the remuneration of the official receivers, when they act as trustees, should be calculated and paid in accordance with the same criteria that would apply in the case of private trustees. There is no reason why it should be otherwise. Similarly, in the case of arrangements for "small debtors", there is no reason why creditors should not be called upon to contribute to the cost of the services, through a levy on monies paid to them under such arrangements.

CHAPTER 7

THE COURTS

3.7.01 There has been no consistency in Canadian legislation in designating the courts that have jurisdiction over bankruptcy and insolvency. Courts that have been given jurisdiction, at one time or another, have included the Superior Courts of the provinces, County and District Courts, the Court of Probate in Nova Scotia and provincial Boards of Review.[1]

3.7.02 A legacy of this legislative tinkering is a certain amount of confusion concerning the exact jurisdiction of the courts and of their officers. This confusion originated with the creation of the new Bankruptcy Courts in 1919 and in their hasty abolition in 1922.

3.7.03 To better understand how this confusion originated and developed, it is helpful to consider the following sections of the 1919 Act which relate to the jurisdiction and procedure of the courts:

> 63 (1) The following named courts *are constituted Courts of Bankruptcy and invested . . . with such jurisdiction at law and in equity* as will enable them to exercise

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[1] *The Insolvent Act of 1869,* 32-33 Vic., Can. S. 1869, C. 16, s. 142 (the Superior Courts in the Province of Quebec and Nova Scotia and county courts in Ontario and Quebec); *The Insolvent Act of 1875,* 38 Vic., Can. S. 1875, C. 16 s. 2 (c) (the Superior Courts in Manitoba and Quebec, the county courts in New Brunswick, Ontario and Prince Edward Island and the Court of Probate in Nova Scotia until county courts are established); *An Act Respecting Insolvent Banks, Insurance Companies, Loan Companies, Building Societies and Trading Corporations* (later known as the *Winding-Up Act*) 45 Vic., Can. S. 1882, C. 23, s. 4 (the Superior Courts of all provinces and in the North West Territories and District of Keewatin "such court or magistrate or other judicial officer as may be designated . . ."); *The Bankruptcy Act,* 9-10 Geo. V., Can. S. 1919, C. 36 s. 63 (1) (Courts of Bankruptcy); *The Bankruptcy Act Amendment Act, 1922,* 12-13 Geo. V., Can. S. 1922, C. 8, s. 8 (1) (the Superior Courts of the Provinces); *The Companies' Creditors Arrangement Act, 1933,* 23-24 Geo. V., Can. S. 1932-33, C. 36, s. 2 (a) (the Superior Courts of the Provinces); *The Farmers' Creditors Arrangement Act, 1934,* 24-25 Geo. V., Can. S. 1934, C. 53, ss. 5 (1), 12 (1) (Boards of Review, the Superior Court in Quebec and County and District Courts in other provinces); *The Bankruptcy Act, 1949,* 13 Geo. VI (2nd sess.) Can. S. 1949, C. 7, s. 140 (the Superior Courts of the Provinces): *The Bankruptcy Amendment Act, 1966,* 14-15 Eliz. II, Can. S. 1966, C. 32, s. 173 (b) (the District Courts of Alberta and the County Court of Manitoba—in relation to the new Part X of the Act).

original, auxiliary and ancillary jurisdiction in bankruptcy and in other proceedings authorized by this Act . . .

(3) The courts in this subsection named *are constituted Appeal Courts of Bankruptcy* . . .

64 (3) . . . *all the powers and jurisdiction in bankruptcy* and otherwise conferred by this Act *may and shall be exercised by or under the direction of one of the judges of the court* upon which such powers and jurisdiction are so conferred, *and the Minister of Justice shall from time to time assign a judge or judges of such court for that purpose* . . .

65 (1) The registrars of the several courts exercising bankruptcy jurisdiction under this Act shall have the powers and jurisdiction in this section mentioned . . .

2 In this Act, unless the context otherwise requires or implies, the expression, . . . (ee) "registrar" includes any other officer who performs duties like those of a registrar; . . . . .[2]

3.7.04 In 1922, the Ontario Court of Appeal, expressed the view that, in enacting a bankruptcy statute, Parliament would be competent to entrust its administration to provincial courts and judges, but it did question, as it was put by Chief Justice Meredith, whether Parliament had "authority to create a Dominion court and to man it with the provincial courts and judges".[3]

3.7.05 Parliament reacted quickly by deleting the words "are constituted Courts of Bankruptcy". The amending statute[4] also provided that the designation of judges to assume primary responsibility for the administration of the Act should reside in the several provincial Chief Justices and not as theretofore, in the Minister of Justice. No other changes have been made since. The curious result is that, although the provincial Superior Courts now have jurisdiction in bankruptcy, the apparatus of the former federal bankruptcy court still remains. This explains most of the present confusion surrounding the bankruptcy and insolvency jurisdiction of the courts.

3.7.06 Section 140 of the Bankruptcy Act is a good example of how confusing the provisions of the Bankruptcy Act concerning the Courts can be. It purports to vest jurisdiction in bankruptcy in the several provincial Superior Courts. If the section were deleted, there would be no change in the result. Superior Courts have jurisdiction in respect to all federal statutes, unless a federal statute stipulates to the contrary.[5] The problems resulting from the vesting of the provincial courts with "such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy" has been discussed *supra* in 2.3.11.

3.7.07 Section 142 is another section that, in the context of the present Act, is largely meaningless. It purports to give to the Chief Justice of the Superior Courts the right to assign bankruptcy work to judges. The several Chief Justices have this power apart from the statute. To provide that the judgment of a single judge shall be deemed to be the judgment of the court is again saying no more than what would be the law without the section. Subsection 2, which purports to preserve and

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[2] *The Bankruptcy Act,* 9-10 Geo. V., Can. S. 1919, C. 36. Italics have been added.
[3] *In re Canadian Western Steel Co. Ltd.,* 2 C.B.R. 494, at p. 500.
[4] *The Bankruptcy Act Amendment Act, 1922,* 12-13 Geo. V., Can. S. 1922, C. 8.
[5] For a brief discussion of this question, see *supra* 1.4.29.

maintain, in all Superior Court judges, jurisdiction in bankruptcy, does not seem to add any greater authority to section 140, which gives the bankruptcy jurisdiction to the Superior Courts in the first place. As we have seen in the preceding paragraph, this jurisdiction would have vested in these courts and their judges, even if nothing had been said in the Act.

3.7.08 Section 144(1), which provides that every court shall have a seal, and section 144(4), which provides that the court shall hold periodic sittings, had a real meaning in the context of the 1919 Act when the new Courts of Bankruptcy were created. These sections, under the present Act, have no meaning, as the courts having jurisdiction are the Superior Courts which have their own seals and their own provisions for holding periodical sittings.

3.7.09 The office and function of the registrar under the present Act are particularly anomalous. During the period when there was a federal Court of Bankruptcy, i.e., 1919-1920, the registrar fulfilled a useful and necessary function. A court was constituted, judges were designated, but there were no clerks or other necessary officers. To remedy this, "the Chief Justice of each court upon which such powers and jurisdiction are so conferred" was empowered to "appoint . . . such registrars, clerks, and other officers in bankruptcy as he deems necessary . . .". This in itself was not particularly clear. There was no provision for designating one of the judges of the Court of Bankruptcy as Chief Justice, but the intention, no doubt, was to refer to the Chief Justices of the several provincial Superior Courts which were "constituted Courts of Bankruptcy". Although it remained in the discretion of the Chief Justice to appoint a registrar, the Act conferred upon the latter a number of specific powers, the exercise of which were deemed to be the orders or acts of the court.

3.7.10 Once the Court of Bankruptcy was abolished, there was no necessity for continuing the practice of appointing "registrars, clerks and other officers in bankruptcy". All necessary functions and duties, which did not require to be exercised by a judge, could be performed by the other regular Superior Court officers.

3.7.11 Although there is some doubt as to whether or not the registrar is a provincial or federal judicial officer, Parliament has the power to impose duties upon provincial court officials in regard to matters within its legislative field. It would seem however, to be the safest conclusion that registrars, both under the 1919 Act, when there was a federal Bankruptcy Court, and under the present Act, are federally appointed officers with a limited jurisdiction under the *Bankruptcy Act.* Although they may be at the same time and for other purposes, provincial court officers, their jurisdiction as registrars flows, not from any appointment as officers of the provincial Superior Courts, but from their appointment by the Chief Justices under the authority delegated to them by the *Bankruptcy Act.*

3.7.12 In 1936, the Ontario Court of Appeal held that registrars were not judges.[6] In 1949, however, new powers have been given to the registrars.[7] Since then, the Act also provides that the powers and jurisdiction of registrars may be exercised by judges, that a registrar may refer any matter ordinarily in his jurisdiction to a judge for disposition, and that a judge may direct that any matter before a registrar be brought before him for hearing. The Ontario Court of Appeal implied that the strongest ground for holding a registrar to be a judge was the provision that "any order made or act done by such registrars in the exercise of the said powers and jurisdiction shall be deemed the order or act of the court", and that this was not a sufficient reason for holding the registrar to be a judge. With the very much extended judicial powers of a registrar, there is reason to doubt whether the courts would today come to the same conclusion. Certainly, the doubt remains as to whether or not registrars are junior federal judges acting within the framework of the provincial Superior Courts. In our opinion, it is not desirable to perpetuate this untidy and confusing situation.

3.7.13 A decision must also be made as to which court should have jurisdiction. When this decision is made, the entire jurisdiction over bankruptcy and insolvency should be given to that court. The courts that might reasonably be considered in this connection are the provincial Superior Courts, and the Exchequer Court, which would become the Federal Court of Canada, if Bill C-192, read for the first time in the House of Commons on March 2, 1970, becomes law. The chief advantage in designating the Exchequer Court as the court having jurisdiction in bankruptcy is that it would assist in creating a greater uniformity of law than now exists when there is only the occasional appeal to the Supreme Court of Canada and not too many to the provincial Courts of Appeal. This advantage, however, would be more than largely offset by the numerous problems and uncertainty that would result for the litigants having to decide, with respect to many matters, whether the Superior Court of their province, or the Exchequer Court, has jurisdiction. Similar difficulties arise under the present Act, as the rules of procedure prescribed by and under the Act must be followed when the Superior Court is sitting in bankruptcy. To vest the Exchequer Court with jurisdiction in bankruptcy would only compound a difficult situation, as bankruptcy often involves problems of property and civil rights and no federal court, other than the Supreme Court of Canada, could exercise general jurisdiction over the matters coming within the exclusive legislative authority of the provinces.[8] In our opinion, the disadvantage in giving jurisdiction to the Exchequer Court, in preference to the provincial Superior Courts would outweigh the advantages.

3.7.14 As the office of registrar is somewhat of an anomaly, we see no need why this should be perpetuated. In this respect, it should be recalled that the workload

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[6] *In re Thomas H. Collings,* (1935-36) 17 C.B.R. 390 at 402.

[7] For example, the power to hear and determine matters relating to proofs of claims whether or not opposed (s. 149(1) (h); the power to tax or fix costs and to pass accounts (s. 149(1) (i)); the power to hear and determine any matter with the consent of all parties (s. 149(1) (j)); and the power to hear and determine any matter relating to practice and procedure in the courts (s. 149(1) (k)).

[8] See *supra,* 1.4.28

of the court will be considerably reduced if our recommendations relating to the discharge of trustees[9] and the passing of the accounts of trustees, lawyers and others[10] are accepted. We, therefore, recommend that the office be abolished. This is not to say that there will be no officers such as clerks, masters, prothonotaries, or other court officials, to assist the court in the discharge of its responsibilities. We believe, however, that the decision as to whether administrative support is required should be made by each provincial authority, having regard to the normal practice of the courts in other matters. It should be open to these authorities to designate the functions to be performed by officers other than judges, in all matters not specifically assigned to a judge by the Bankruptcy Act.

[9]See *supra*, 3.6.36
[10]See *supra*, 3.6.35

APPENDIX A

PARTIAL LIST OF ORGANIZATIONS WHICH HAVE SUBMITTED WRITTEN MEMORANDA

Textile Wholesalers Association 1951
L'Association du Notariat Canadien (Conseil régional du district de Terrebonne) 1952
Canadian Federation of Mayors and Municipalities 1954
La Corporation des Entrepreneurs en Plomberie & Chauffage de la Province de Québec (Section du St-Maurice) 1954
Natural Gas and Petroleum Association of Canada 1957
The Canadian Credit Institute (Montreal Chapter) 1957
Joint Committee of the Ladies Cloak & Suit Industry of the Province of Quebec 1958
Ontario Municipal Association 1958
Barreau de Bedford (Québec) 1958
The Canadian Bankers' Association 1959
Rapport du Comité des faillites de la Chambre de Commerce du district de Montréal 1960
La Chambre de Commerce du district de Montréal 1960
Conseil de la Chambre des Notaires de la Province de Québec 1960
Canadian Collectors Association 1960
Debtors' Assistance Board (of Alberta) 1960
General Council of the Bar of the Province of Quebec 1960
The National Retail Lumberman's Council of Canada 1960
The Credit Granters' Association of Montreal on behalf of The Credit Granters' Association of Canada 1960
Canadian Collectors Association 1961
L'Union Commerciale Mauricienne Inc. 1961
Association des Manufacturiers de Meubles de la Province de Québec Inc. 1961
National Garment Salesmen's Association of Canada 1961
Canadian Lumbermen's Association 1961
Ontario Insurance Agents' Association 1961
La Chambre de Commerce du District de Montréal 1961
Greater Toronto Business Men's Association 1961
The Board of Trade of Metropolitan Toronto 1961
The Federation of Canadian Commercial Travellers Association 1961
The Canadian Bar Association 1961
National Associated Women's Wear Bureau 1961
Board of Trade of Metropolitan Toronto 1961
Canadian Construction Association 1962
Canadian Small and Independent Business Federation 1962
The Ontario Retail Lumber Dealers Association 1962
The Canadian Credit Men's Trust Association Limited 1962
The Manitoba Subsection of the Commercial Law Committee of the Canadian Bar Association 1962
La Fédération des Chambres de Commerce des Jeunes de la Province de Québec 1962
Barreau de Bedford (Québec) 1962
National Concrete Products Association 1963
The Canadian Institute of Chartered Accountants 1963
L'Association du Barreau Rural de la Province de Québec 1963
L'Association des Syndics de la Province de Québec 1964
The Canadian Credit Men's Association Limited 1964
Barreau de la Province de Québec 1964
Canadian Builders Supply Association 1964
The Ontario Retail Lumber Dealers Association 1964
La Chambre de Commerce du district de Montréal 1965

APPENDIX B

THE STUDY COMMITTEE ON BANKRUPTCY LEGISLATION QUESTIONNAIRE FOR OFFICIAL RECEIVERS

1. Would you indicate:
   (a) Your academic background?
   (b) Your previous occupations to the present one?
2. What position do you hold or what function do you exercise aside from your being an Official Receiver in bankruptcy?
3. If you are employed part-time doing bankruptcy work, would you indicate how much of your time is spent on bankruptcy matters?
4. Do you feel that the facilities that are now available to you are sufficient to enable you to discharge your functions under the Bankruptcy Act in an adequate and expeditious manner?
5. Would you list the employees that work under your direction by referring to the nature (whether clerical, secretarial etc.) of their positions?
6. What *total* remuneration have you received from the provincial authorities for each of the years 1962 to 1965 inclusive?

   1962:
   1963:
   1964:
   1965:

7. If the provincial authorities have, pursuant to Section 170, allowed to you the fees payable under the tariffs established by the General Rules, would you indicate how much money you have received from this source for each of the years 1962 to 1965 inclusive?

   1962:
   1963:
   1964:
   1965:

8. If the last question does not apply, would you indicate which portion of the remuneration that you are in receipt of from the provincial authorities represents, or could be deemed to represent, a remuneration for the services rendered by you under the Bankruptcy Act?
9. (a) In the case of an assignment, do you, as Official Receiver, in actual practice, appoint the trustee by reference to the wishes of the most interested creditors?
   (b) What steps do you take to ascertain the wishes of the creditors?
10. (a) Are many assignments filed with you, as Official Receiver, in which the trustee's name is already typed in?
    (b) In approximately what percentage?
11. (a) Does it happen that debtors are unable to file assignments because they cannot make any arrangements to guarantee a minimum fee to the trustee?
    (b) Pursuant to Section 26(5), how often does it happen that you have to cancel an assignment because you are unable to find a licensed trustee willing to act?
12. (a) Do you, in actual practice, personally examine the bankrupt under oath as contemplated by Section 120?
    (b) If you do personally examine the bankrupt, do you consider that the questions in Form No. 62 or 63 adequately cover the matters that should be investigated in relation to the conduct of the bankrupt, the causes of his bankruptcy and the disposition of his property?
    (c) If you do not personally examine the bankrupt, would you indicate the nature and the mechanics of any arrangements that you may make to have the bankrupt examined?
13. (a) Do you usually personally preside at the first meeting of creditors?
    (b) If not, would you indicate the arrangements that you make for your replacement?

14. Do you keep in your office for public reference a copy of each issue of the *Canada Gazette* that contains a notice referring to bankrupts?
15. Do you keep an index book wherein you enter *alphabetically* the name of each bankrupt in respect of whose estate a notice may at any time appear in the *Canada Gazette?*
16. If you do keep an index book, indicate whether it covers the whole of Canada and if not, indicate which bankruptcy division or districts (provinces) are covered.
17. Indicate whether it is presently up to date and if not, indicate the last day on which it was.
18. If you do not keep an up-to-date index book, would you indicate the reasons why?
19. Would you give some indication as to the number of searches that were made of the *Canada Gazette* and the index book kept by your office pursuant to Section 167(2) during the last 5 years?

    Canada Gazette:
    Index Book:
20. Would you give some indication as to the number of certificates issued by your office pursuant to Section 167(2) during the last 5 years?
21. Would you indicate what problems, according to your personal experience, you feel the Committee should consider regarding the office, functions and duties of the Official Receiver as they are defined by the present legislation?

    What do you think should be done to solve these problems?
22. Would you indicate if there would be any need for Official Receivers to convene annually, or at more frequent intervals, on a regional or national basis in order to discuss problems related to the administration of the Act and possible remedies, as is done in other jurisdictions with court officials?

APPENDIX C

THE STUDY COMMITTEE ON BANKRUPTCY LEGISLATION QUESTIONNAIRE FOR REGISTRARS

1. Would you indicate:
   (a) Your academic background?
   (b) Your previous occupations to the present one?
2. What position do you hold or what function do you exercise aside from your being a Registrar in bankruptcy?
3. If you are employed part-time doing bankruptcy work, would you indicate how much of your time is spent on bankruptcy matters?
4. Do you feel that the facilities that are now available to you are sufficient to enable you to discharge your functions under the *Bankruptcy Act* in an adequate and expeditious manner?
5. Would you list the employees that work under your direction by referring to the nature (whether clerical, secretarial etc.) of their positions?
6. What *total* remuneration have you received from the provincial authorities for each of the years 1962 to 1965 inclusive?

   1962:
   1963:
   1964:
   1965:

7. If the provincial authorities have, pursuant to Section 170, allowed to you the fees payable under the tariffs established by the General Rules, would you indicate how much money you have received from this source for each of the years 1962 to 1965 inclusive?

   1962:
   1963:
   1964:
   1965:

8. If the last question does not apply, would you indicate which portion of the remuneration that you are in receipt of from the provincial authorities represents, or could be deemed to represent, a remuneration for the services rendered by you under the Bankruptcy Act?
9. Would you indicate how many, as well as what percentage, of the applications for interim receiver pursuant to Section 24 filed with you, as Registrar, are refused?

   Number:
   Percentage:

10. Do you keep in your office for public reference a copy of each issue of the *Canada Gazette* that contains a notice referring to Bankrupts?
11. Do you keep an index book wherein you enter *alphabetically* the name of each Bankrupt in respect of whose estate a notice may at any time appear in the *Canada Gazette?*
12. If you do keep an index book, indicate whether it covers the whole of Canada and if not, indicate which bankruptcy division or districts (provinces) are covered.
13. Indicate whether it is presently up to date and if not, indicate the last day on which it was.
14. If you do not keep an up-to-date index book, would you indicate the reasons why?
15. Would you give some indication as to the number of the searches that were made of the *Canada Gazette* and the index book kept by your office pursuant to Section 167(2) during the last 5 years?

    Canada Gazette:
    Index Book:

16. Would you give some indication as to the number of certificates issued by your office pursuant to Section 167(2) during the last 5 years?

17. Would you indicate what problems, according to your personal experience, you feel the Committee should consider regarding the office, functions and duties of the Registrar as they are defined by the present legislation?

    What do you think should be done to solve these problems?

18. Would you indicate if there would be any need for Registrars to convene annually, or at more frequent intervals, on a regional or national basis in order to discuss problems related to the administration of the Act and possible remedies, as is done in other jurisdictions with court officials?

APPENDIX D

SUMMARY OF THE MAJOR RECOMMENDATIONS

I – GENERAL

1. There is an overriding need for a new bankruptcy and insolvency statute that would provide for an integrated and comprehensive bankruptcy system, devised to suit the needs of our time. (2.4.02)

2. With respect to the problems of international bankruptcies, attempts should be made to negotiate international agreements on conflict rules with countries that trade substantially with Canada. (2.4.03)

II – MEASURES TO FACILITATE THE PAYMENT OF DEBTS

3. The provisions relating to arrangements, now found in four statutes, should be brought together and placed in the *Bankruptcy Act.* (3.1.09)

4. The new procedures should be as flexible as possible so as to permit the greatest variety of arrangements to suit as many situations as possible. (3.1.09)

5. An insolvent debtor should be authorized to file a notice of his intention to present a proposal for an arrangement. Upon the filing of the notice of intention, there would be a short stay of proceedings during which the debtor could formulate his proposal and arrange the necessary financing, guarantees and other details. (3.1.10 to 3.1.12)

6. With respect to "small debtors", two types of arrangements should be established. (3.1.20)

7. Arrangements by way of an extension would be for "small debtors" who need only time to pay all of their debts in full. (3.1.21 and 3.1.22)

8. For the "small debtors" who cannot be expected to pay their debts in full, there should be available a single and inexpensive procedure permitting them to make a composition with their creditors. At the end of the term of the arrangement, the debtor would receive a release from the balance of his debts. The creditors should receive more under such an arrangement than what they could expect to receive under an immediate bankruptcy. (3.1.23 to 3.1.25)

9. Both plans for an arrangement by "small debtors" should be for a maximum term of three years, but, there should be a provision allowing the debtor, under certain conditions, to suspend his payments and to make up, after the term contemplated for the arrangement, the payments he has missed. (3.1.26)

10. In order to help the "small debtor" learn money management and to resist the many pressures that can lead to recurring financial difficulties and insecurity, it would be essential that every step be taken to ensure that debtors under a plan fully use the services of agencies providing advice on the preparation of a family budget and financial guidance and counselling. Because of the major role these agencies could have in the financial rehabilitation of the debtor, the government should be prepared to assist them and, where they do not exist, to provide the service directly to these small debtors. (3.1.27)

11. In all types of arrangement, there should be summary procedures to provide relief, with suitable safeguards, against harsh and unconscionable transactions and for the disclaimer of executory contracts or leases. (3.1.29 to 3.1.31)

12. Under the general plan for an arrangement, the secured creditor would keep his right, under his contract, to repossess or liquidate his security. However, unless the debtor is otherwise in default, the mere fact that the debtor has become insolvent or bankrupt or has filed a petition for an arrangement, should not permit the creditor to accelerate the payments under the contract or to repossess or liquidate the security, notwithstanding any provision contained in the contract or any statutory rule to the contrary. (3.1.33)

13. The legislative change recommended in the preceding paragraph should also apply in the case of arrangements by "small debtors". Further restrictions should also be imposed on the rights of a creditor having a security on a movable and on those of an unpaid vendor of movables, in the case of arrangements by small debtors. Under an extension arrangement, a creditor should not be permitted to exercise any right he may have under a security on a movable, unless the security was given during the sixty days prior to the filing of the petition for an arrangement and less than two-thirds of the amount owing has been paid. In order to provide for an adequate safeguard against abuses on the part of debtors in these circumstances, the secured creditor should be given the right to choose, within a certain delay, between filing a claim under the plan or maintaining his rights under the contract. Still other considerations apply in the case of an arrangement by way of a composition by a small debtor as, under such an arrangement, the debtor does not contemplate paying his debts in full. In such circumstances, the secured creditor should be given the right to choose, within a certain delay, between filing a claim under the plan or maintaining his rights under the contract, in every case where the debtor has not already paid two-thirds of the amount owing. (3.1.35 and 3.1.36)

14. In the cases where a deficiency claim is permitted, there should be a summary procedure to adjust the value of the deficiency claim to the amount it would have been, if the secured creditor had used reasonable diligence and prudence in the liquidation of the security. (3.1.39)

15. There should be a procedure permitting the temporary suspension of the principal payments on immovable property, any amount not paid during the period of suspension to be made up by the debtor, when the period of suspension is lifted. (3.1.40)

16. The Governor in Council should be granted the authority to proclaim, in the case of an emergency, a moratorium for any specified region of the country or designated industry staying for a short period of time all proceedings against those affected. However, in order to prevent possible abuse and hardship, the court should be given the power to lift the moratorium in respect to a particular debt, if the balance of convenience and hardship indicates that it is just to do so. (3.1.41)

III – THE LAST RESORT SOLUTION

17. Bankruptcy should be equally available to, or against, all debtors. (3.2.006)

18. There should be no minimum amount of debt that a debtor must have to become voluntarily bankrupt. (3.2.008)

19. In the case of an involuntary bankruptcy, the amount of debt that must be owed to the petitioning creditor or creditors should remain at one thousand dollars. (3.2.008)

20. Any agency or department of government, whether federal or provincial, that exercises a regulatory or supervisory authority over the financial affairs of a debtor, should be given the means of initiating bankruptcy proceedings wherever this would be necessary for the protection of the public interest. (3.2.014)

21. The Superintendent of Bankruptcy should also be authorized to initiate bankruptcy proceedings against a debtor in any case where, as a result of an investigation, the suspicions of offences and of an impending bankruptcy are confirmed. (3.2.015 and 3.4.22)

22. The traditional concept of "acts of bankruptcy" should be abolished and conclusive and *prima facie* presumptions that the debtor has ceased to pay his debts generally as they mature should be enacted. (3.2.019)

23. A petitioning creditor should be entitled to a receiving order if he can show, in any way, that the debtor has ceased to pay his debts generally as they mature. (3.2.019)

24. Creditors who have obtained a final judgment against a debtor could serve on him a bankruptcy notice demanding payment of that debt. Non compliance by the debtor would constitute a presumption that he has ceased to pay his debts generally as they mature. (3.2.020 to 3.2.023)

25. Where a person carries on business through the means of a limited liability corporation that he, or persons related to him, control and, that becomes

bankrupt, the court should have, in specific circumstances, the power to order that person to pay to the estate in bankruptcy of the corporation an amount being the equivalent to the deficiency between the assets and liabilities of the corporation at the time of bankruptcy. Such person should, however, be allowed to limit his liability by proving that the loss suffered by the creditors and resulting from his misconduct was less than such deficiency. (3.2.026)

26. The nature of the property to be exempted from seizure on the bankruptcy of a debtor should continue to be established by the provinces. The bankrupt should, however, be required to decide between keeping all his exempt property, as determined by provincial laws, and not obtaining a release of his debts, on the one hand, and giving up some of his exempt property and obtaining a release of his debts, on the other. (3.2.031 to 3.2.034)

27. In the case of the bankruptcy of any debtor, the mere fact that the debtor has become insolvent or bankrupt or has filed a petition for an arrangement, should not permit the creditor to accelerate the payments under the contract or to repossess or liquidate the security, unless the debtor is otherwise in default. (3.2.037)

28. The secured creditor should not be allowed, in any case, to repossess or realize his security, whether on movable or immovable property, without having first proven the validity and value of his security, and given the trustee the opportunity to attack the security, to redeem it or to pay any arrears on the debt. (3.2.038)

29. In all the cases where there would have been repossession or realization of movable or immovable property, either before or after bankruptcy, there should be a summary procedure to adjust the value of any deficiency claim that may remain to the amount it would have been, if the creditor had used reasonable diligence and prudence in the liquidation of the security. (3.2.039)

30. In the case of the bankruptcy of a "small debtor", there should be no other change in the treatment of creditors having a security on immovable property. (3.2.040)

31. The creditor having a security on movables should be prevented from realizing or repossessing the security where the debtor has paid two-thirds of the amount owing. If less than two-thirds of the amount owing is paid, the secured creditor should be given the right to choose, within a certain delay, between filing a claim in the bankruptcy or maintaining his rights under the contract. Where the creditor chooses to maintain his rights under the contract or in the cases where he has already exercised them before the bankruptcy, his claim for any balance of the debt should be postponed until the claims of all other creditors are paid in full. In order for the system to be effective, these restrictions should also be imposed on the rights of an unpaid vendor of movables. (3.2.040)

32. The use of deemed trusts to circumvent the scheme of distribution in the *Bankruptcy Act* should be avoided where there is not, in the estate, at the time of the bankruptcy, sufficient money to satisfy the claim for the money deducted. (3.2.043)

33. Governments should be subject to the same rules for the perfection of their security interests as are applicable to other creditors holding similar securities. (3.2.044)

34. A provision should be added to the *Bankruptcy Act* similar to that contained in articles 1998 and 1999 of the *Civil Code* of Quebec regarding thirty days goods. (3.2.045)

35. After-acquired property should not vest in the trustee, except in the case of property that a bankrupt acquires by inheritance within six months after bankruptcy and where a debtor, within a certain period of time after his bankruptcy, acquires great wealth. (3.2.048)

36. The *Bankruptcy Act* should cover the entire field of fraudulent conveyances, so as to make available, in the case of an estate administered under the *Bankruptcy Act,* reliefs similar to those provided by the *Fraudulent Conveyances Act* and articles 1032-1040 of the *Civil Code.* (3.2.054)

37. Where a security is held to be preferential, the court should have the power to order that the security be assigned to the estate instead of avoiding it. (3.2.061)

38. The property in a depository, regardless of the order in which the property was deposited, should, in case of bankruptcy of the debtor, be distributed, first, to his trustee in bankruptcy, to the extent that any deposits made by the debtor are voidable as against the trustee, and, thereafter, to all depositors on a pro rata basis. (3.2.062)

39. All contingent or unliquidated claims to which a bankrupt is subject at the date of his bankruptcy should be provable claims and, in all cases, the court should be required to summarily value the same. (3.2.064)

40. The priority given for funeral and testamentary expenses should be abolished. (3.2.069)

41. The costs of administration, the expenses and fees of the trustees and legal costs should continue to be paid in priority to all other costs. (3.2.070)

42. The levy payable to the Superintendent should continue to be paid immediately after the other costs of administration, in priority to the other creditors. (3.2.071)

43. Wages and other monetary compensation for services rendered to the bankrupt during the three months preceeding the bankruptcy should remain as a priority and should be increased to one thousand dollars. (3.2.072)

44. The priority for municipal taxes should be abolished. (3.2.073)

45. The priority of the landlord for three months rent in arrears next preceeding the bankruptcy should be retained but the priority for three months accelerated rent should be abolished. (3.2.074)

46. The priority of the Crown should be abolished. (3.2.079)

47. The claims of certain creditors should be postponed until the claims of all other creditors have been satisfied. (3.2.080)

48. The debtor should be released from all claims that may be proved against the estate, except a fine or penalty imposed by a court and the dividend a creditor would have been entitled to receive on any claim not disclosed to the trustee where such creditor had no notice of the bankruptcy. (3.2.087)

49. While the debtor would not be released from a fine or penalty through the bankruptcy process, consideration should be given to granting to some other agency the authority to make an order releasing him from such a debt. (3.2.087)

50. The release of a debtor from his debts should be unconditional and take effect as of the date of bankruptcy. (3.2.088)

51. The release of debts should have the effect of extinguishing the liability of the debtor to pay the debt and any express or implied promise to revive such liability should be unenforceable. (3.2.088)

52. The court should have the power to annul a release of debts resulting from a bankruptcy that has occurred less than five years after another bankruptcy, in any case where the debtor has, in effect, abused the bankruptcy process to the detriment of his creditors. (3.2.090)

53. The legal status of a bankrupt should apply not only to all individual debtors, but also to such directors or officers of a corporation (including those who, in fact, control the affairs of the corporation) who are, for example, primarily responsible for the bankruptcy of a corporation or who have substantially aggravated its insolvency. (3.2.096)

54. No contract in respect of which credit is extended by or to a bankrupt in the course of his carrying on a business would be enforceable. (3.2.097)

55. Any bankrupt in a position to show that his bankruptcy was caused by circumstances beyond his control could, at any time after one month of the making of a bankruptcy order, apply to the court for a certificate terminating his status of a bankrupt. (3.2.097)

56. The status of a bankrupt would, in all cases, terminate without an order five years after it commenced. (3.2.097)

57. The new statute should incorporate the special provisions relating to the insolvency of banks, railways and insurance companies now found in other federal legislation. (3.2.102)

58. As a rule, an insolvent bank should be liquidated pursuant to the general provisions of the *Bankruptcy Act,* in the same manner as any other commercial debtor, except insofar as these general rules need to be modified to conform with the special provisions now contained in the *Bank Act,* the *Quebec Savings Bank Act,* and the *Winding-Up Act* relating to the liquidation of insolvent banks. (3.2.103)

59. A creditor of a railway should have the right to petition a railway into bankruptcy. Such a petition would be served upon the debtor, the Canadian Transport Commission and the Minister of Transport. Proceedings would then be stayed for sixty days unless the Commission and the Minister consents to the stay being lifted. If the debt is not satisfied within sixty days, the claimant could proceed with the petition. (3.2.105)

60. Part III of the *Winding-Up Act* and the sections relating to the liquidation of insolvent insurance companies in the *Canadian and British Insurance Companies Act* and the *Foreign Insurance Companies Act* should be incorporated into the new *Bankruptcy Act.* (3.2.107)

61. A special uniform procedure should be devised to handle and settle all claims by the customers of a bankrupt stockbroker similar to that provided by section 60C of the United States *Bankruptcy Act.* (3.2.109)

62. Provisions governing the relations of a landlord and tenant, on the bankruptcy of the tenant, should be re-introduced into the *Bankruptcy Act.* (3.2.111)

IV – LIQUIDATION OUTSIDE BANKRUPTCY

63. Whenever a corporation is insolvent, whether or not it is bankrupt, there should be certain minimum requirements in the conduct of a liquidation by bondholders, through a receivership, in order to protect the interests of junior bondholder and unsecured creditors. (3.3.07)

64. Only a receiver who holds a licence to be a trustee under the *Bankruptcy Act* should have the right to act as receiver, manager or liquidator. (3.3.07)

65. The indenture trustee should not himself be the receiver. (3.3.07)

66. In principle, the term of a receivership should not be longer than two years. (3.3.07)

67. Generally, the receiver, within three months of his appointment, should call a meeting of all creditors. (3.3.07)

68. At the meeting of creditors, the receiver should disclose all circumstances and reveal how he proposes to exercise the powers given to him by the court. (3.3.07)

69. The creditors should have the power to appoint a creditors' committee. (3.3.07)

70. Anyone interested should be able to apply, in a summary manner, to the court for the review of any decision of the receiver. (3.3.07)

71. The receiver should be required to pass his accounts once a year. (3.3.07)

72. The court should have the power to order, on the application of an interested person, that, where the credit was extended for a business purpose, the liquidation of movable property by or on behalf of a secured creditor should be conducted according to the rules outlined above. (3.3.08)

V – CRIME AND THE PROTECTION OF OUR CREDIT SYSTEM

73. The courts should have the alternative of imposing a fine or imprisonment, for all offences, rather than the present requirement of a mandatory jail sentence. (3.4.09)

74. In view of the altered status of a "bankrupt", criminal as well as civil penalties will be required to enforce the prohibitions that will be attached to this new status. (3.4.14)

75. The importance of the detection, investigation and prosecution of suspected offences need to be emphasized. (3.4.15)

76. The Superintendent of Bankruptcy should be empowered to initiate an investigation before bankruptcy occurs whenever there are reasonable grounds for suspecting that the abuses complained of have resulted or are likely to result in the insolvency of a debtor. (3.4.22)

77. Any special powers given the Superintendent for the purpose of these investigations should be exercised under the supervision of a Court or a quasi-judicial tribunal. (3.4.22)

78. As a complement to the power to launch an investigation in such circumstances, the Superintendent should be authorized to initiate bankruptcy proceedings in any case where the suspicions of offences and of an impending bankruptcy are confirmed. (3.4.22)

79. The Superintendent should be empowered to investigate offences under the *Criminal Code* that have been devised to protect the soundness of our credit system. (3.4.23)

80. The authority of the Attorney General of Canada to take before the courts without the intervention of the provincial authorities, the matters that have been investigated by the Superintendent, should be placed beyond a doubt. (3.4.26)

VI – THE ADMINISTRATION

81. The principle of creditor control should no longer be the cardinal principle upon which the administrative machinery of the bankruptcy system should be based. (3.6.12)

82. The administrative branch of the federal government should assume greater responsibilities in the administration of insolvent estates. (3.6.12)

83. Only the official receiver should be appointed as interim receiver. (3.6.20)

84. In every estate, the official receiver should be the first trustee, from the date of bankruptcy to the date of the first meeting of creditors. (3.6.23)

85. The official receiver should, in all cases, initially take possession of the property of the bankrupt and make an inventory of it. (3.6.24)

86. At the first meeting, the creditors would decide whether they wish to have a public or private trustee to administer the estate. (3.6.25)

87. There should be provisions for the appointment of a Board of Inspectors in every estate, except with respect to estates in which the official receiver is the trustee. (3.6.27)

88. The Superintendent should also have the power to establish a Board and appoint inspectors, where the creditors have failed to do so. (3.6.27)

89. The Superintendent should have the power to appoint a representative of the Crown in the right of Canada or of a province to a Board of Inspectors, in any case where the Crown has a claim and requests such an appointment. (3.6.27)

90. The procedure whereby the Superintendent is required to make an investigation into the character and qualifications of an applicant for a licence to act as a trustee, and whereby applicants are required to appear before a Board of Examination should be continued. (3.6.30)

91. No one, whose application for a licence has been refused, should have a right of appeal from the Minister's decision. (3.6.30)

92. Under certain conditions, it should be permissible for corporations to obtain a licence to act as a trustee. (3.6.31)

93. The final decision regarding the suspension or cancellation of a licence or the refusal to renew a licence should be that of an independent tribunal. (3.6.33)

94. There should also be special provisions permitting the Superintendent, under the authority of the tribunal, to take any conservatory measures necessary to protect the creditors' interests before a final decision is reached. (3.6.33)

95. In place of the present system of bonding of trustees, an Indemnity Fund should be created to be administered by the Superintendent. (3.6.34)

96. The Superintendent should be given the exclusive initial responsibility to audit and tax the statement of receipts and disbursements and the accounts of interim receivers, trustees, receivers, solicitors and accountants, and anyone dissatisfied with the taxation should have a right to a review by the Superintendent, with a right of appeal to the court. (3.6.35)

97. A trustee's discharge should be automatic upon the passing of his accounts. (3.6.36)

98. The same rule should apply to interim receivers and receivers. (3.6.36)

99. The Superintendent should be given the responsibility of keeping an index of each bankrupt in respect of whose estate a notice appears in the *Canada Gazette.* (3.6.40)

100. The Superintendent should be required to publish, in a summary form, in the *Canada Gazette,* such particulars of bankruptcy proceedings as may be prescribed. (3.6.41)

101. The Minister should table annually in Parliament a Report regarding the administration of the Act. (3.6.47)

102. As far as possible, all official receivers should be full-time employees of the Public Service. (3.6.43)

103. One official receiver should be appointed in each province with as many deputy official receivers, acting under his general direction, as may be necessary to fulfill their duties. (3.6.43)

104. The official receivers together should be constituted a body corporate to be known as the "Official Receiver in Bankruptcy", which should have perpetual succession and could, in its corporate name, acquire, hold or transfer any property and sue and be sued. Any official receiver would have the authority to do on behalf of the corporation what the corporation would be authorized to do. (3.6.45)

105. A meeting of creditors should be called at the commencement of the administration of every estate, and if no quorum is present, the appointment of the official receiver as trustee will be deemed to have been approved. (3.6.48)

106. The new *Bankruptcy Act* should define what is a conflict of interests. (3.6.50)

107. Everyone who has a conflict of interests should be prohibited from acting for an estate administered under the provisions of the Act. (3.6.52)

108. The government services required to maintain an efficient bankruptcy system should be financially as self-supporting as possible, except those that relate to the enforcement of criminal provisions. (3.6.54)

109. The remuneration of the official receivers, when they act as trustees, should be calculated in accordance with the same criteria that would apply in the case of private trustees. (3.6.54)

110. In the case of arrangements for "small debtors", creditors should pay a levy on monies paid to them under such arrangements. (3.6.54)

VII – THE COURTS

111. The provincial Superior Courts should retain the entire jurisdiction over bankruptcy and insolvency. (3.7.13)

112. The office and functions of the registrar under the present Act should be abolished. (3.7.14)

113. It should be open to provincial authorities to designate the functions to be performed by officers other than judges, in all matters not specifically assigned to a judge by the Act. (3.7.14)